

**CMI – IWG on Ship Security Practices  
Discussion paper for  
International Sub-Committee Meeting,  
Thursday 8<sup>th</sup> November 2018, 9 – 11 am**

**Reed Smith, Broadgate Tower, 20 Primrose Str. London.**

**Executive Summary**

This discussion paper has been prepared by the International Working Group on Ship Finance Security Practices for the purposes of assisting in the debate and deliberations at the International Sub-Committee meeting on Thursday 8<sup>th</sup> November 2018.

1. Section 1 – Introduction – gives some background to the history and circumstances which led to the establishment of the International Working Group (IWG), some observations on the Cape Town Convention and the scope and nature of the questionnaire whose results are now being reported. The IWG had the brief "***To gather as much information as possible from our national maritime law associations on the regimes prevalent in each country on ship finance security practices and the ease or otherwise of the enforcement of maritime securities.***"
2. Section 2 – Some wider background issues and developments - gives some industry content to the issues under discussion including issues related to the international shipping market since the financial crises of 2008 and how financiers and mortgagees have reacted, a summary of developments in relation to the CMI Draft Convention on the International Recognition of Judicial sales including UNCITRAL'S decision at its 51<sup>st</sup> Assembly in New York in June to add cross border issues relating to the international recognition of Judicial Sales to its working agenda, a CMI driven project. It also refers to writings which have considered the subject matter of a Shipping Protocol to the Cape Town Convention.
3. Section 3 – Responses to Questionnaire – gives a high level summary of, and commentary on, the responses received so far from national maritime law associations (NMLAs).
4. Section 4 – Some tentative conclusions – tries to draw some conclusions from the responses so far and contains some observations on the suggested next steps. Its suggestions are made in the context of the fact that it is the role of CMI to do industry' s bidding and thus far input is only from NMLAs; unlike the aircraft industry there does not appear to be a demand from industry for an international regime; thus the CMI would need to decide if it was appropriate for it to form a view on the need for such a regime and if so whether NMLAs through the means of a further Questionnaire should be asked to canvass the views of industry more fully. In that case the remit of the IWG would have to be extended by the Executive Council.

## 1. Introduction

### 1.1 **Brief background**

- 1.1.1 The very first set of draft articles on a "Prospective UNIDROIT Convention on International Interests in Mobile Equipment" prepared by the Study Group of UNIDROIT, provided for the application of the convention to vessels. This idea was discussed by the maritime industry in general including maritime jurists, experts and maritime organisations including the IMO and UNCTAD, and CMI and the conclusion was that whilst such a convention could be very useful indeed to aircraft, rolling stock and space assets, the very need of such a convention to ships was questioned. There was mention of the possible conflict between such a convention and the 1993 Liens and Mortgages Convention. There was also the general feeling that the entire body of maritime law with its very special sector specific rules which had been developing and evolving over the years regulated the rights of various maritime creditors. Most jurisdictions gave special rights to the entire spectrum of maritime creditors either by virtue of already existing international conventions or by virtue of local law and therefore it was difficult to see what precise value such a new regime could provide and how it could effectively improve a system devised as a direct result of the very nature of maritime trade. A number of these rights are not registrable and still enjoy a privileged status. Thus, it was perceived that conflicts between the convention rules and existing law would be rather challenging to overcome, questioning the need of embarking on a protocol related to shipping.
- 1.1.2 As a result subsequent drafts of this convention saw the reference to ships being dropped and when the Convention on International Interest in Mobile Equipment was signed in Cape Town on the 16<sup>th</sup> of November 2001, the protocols which accompanied it related to aircraft, rolling stock and space assets. The Convention became known as the Cape Town Convention.
- 1.1.3 The main proponents of the Aircraft Protocol to the Cape Town Convention consisted of persons immediately involved in the aviation business including the main leading aircraft manufacturers. The protocol was thus driven by the aviation industry.
- 1.1.4 During 2013 there was renewed interest at UNIDROIT with attempts to put the matter of extending the Cape Town Convention to ships back on the Agenda. At the 92<sup>nd</sup> session of the Governing Council of UNIDROIT held in Rome, it is noted that **"The Secretariat accordingly seeks the authorisation of the Governing council to conduct a preliminary study, which should first identify and describe the legal obstacles faced by market participants in the shipping industry concerning security over ships and maritime transport equipment in cross-border situations and give an overview of the status and development of internationally harmonised rules in this field of law."**
- 1.1.5 At the 93<sup>rd</sup> session of the Governing Council also held in Rome in 2014, UNIDROIT assigned a low priority to a possible maritime protocol **"in light of potential industry opposition expressed to some members of the Council, as well as continued, although limited use of the 1993 International Convention on Maritime Liens and Mortgages."**
- 1.1.6 In view of the above and the renewed interest of UNIDROIT in the subject matter, the President of CMI Stuart Hetherington wrote to the Secretary General of UNIDROIT in August 2014 enquiring about the level of priority assigned by UNIDROIT to this work. The reply from Jose Angelo Estrella Faria, was to the effect that other projects enjoy higher levels of priority however **"the informal consultations required to gather information on the actual financing practices of the maritime industry are a most useful activity for us to undertake at the present time and are to be considered as ongoing."**

1.1.7 As a result of the above, it was considered appropriate that CMI embark on the creation of an International working group chaired by Ann Fenech, Managing Partner at Fenech and Fenech Advocates Malta, made up of persons with as wide a geographical spread as possible. As a result, the following were approved Members of the IWG:

Andrew Tetley - Partner at Reed Smith, Paris

David Osborne - Partner at Watson Farley and Williams, London (Rapporteur);

Armstrong Chen - Partner at Rolmax Law Office, Beijing

Souichirou Kozuka - Professor of Law at Gakushuin University, Tokyo

Camila Mendes Vianna Cardoso - Managing Partner of Kincaid Mendes Vianna Advogados, Brazil

Allen Black - Partner at Winston and Strawn, United States

Stefan Rindfleisch - Partner at Ehlermann Rindfleisch and Gadow, Germany

Andrea Berlingieri - Partner at Studio Berlingieri Maresca, Italy

Haco van der Houven van Oordt - Partner at AKD, The Netherlands

1.1.8. The brief of the IWG was "***To gather as much information as possible from our national maritime law associations on the regimes prevalent in each country on ship finance security practices and the ease or otherwise of the enforcement of maritime securities.***"

**1.2. The Convention on International Interests in Mobile Equipment (The Cape Town Convention.)**

1.2.1. The Cape Town Convention, attached as Annex 1 A, is about the creation of a central international register where an international interest in mobile equipment will be registered. There are currently 3 protocols on Aircraft, Railway Rolling Stock and Space Assets.

1.2.2. According to Prof. Roy Goode: "*Its purpose is to provide a stable international legal regime for the protection of secured creditors, conditional sellers, and lessors of aircraft objects, railway rolling stock and space assets through a set of basic default remedies and the protection of creditors interests by registration in an international registry thus securing priority and protection in the event of the debtor's insolvency.*"

1.2.3. It provides for the constitution and effects of an international interest in certain categories of mobile equipment by virtue of the registration of such an international interest in an international register.

1.2.4. Article 2 of the Convention provides that an international interest in mobile equipment is an interest in a uniquely identifiable object granted by the chargor under a security agreement, or vested in a person who is the conditional seller under a title reservation agreement or vested in a person who is the lessor under a leasing agreement.

1.2.5. By way of summary, in the event of default the holder of an international interest can:

- a. Take possession or control of the object
- b. Sell or grant a lease of any such object
- c. Collect or receive any income or profits arising from the management or use of such an object
- d. Any sum collected from the sale is applied towards discharge of the amount of the secured obligations
- e. Where the sums collected or received by the charge exceed the amount secured by the security interest, unless ordered by the court the chargee is to distribute the surplus among holders of subsequently ranking interests which have been registered.

- f. Ownership passing on a sale is free from "any other interest over which the chargee's security interest has priority under the provisions of article 29."
  - g. The buyer buys free from an unregistered interest even if the buyer has actual knowledge of such an interest.
  - h. A registered interest has priority over any other interest subsequently registered and over an unregistered interest.
- 1.2.6. All these rights in the hands of the holder of an international interest would give rise to a number of substantial challenges as regards the maritime law of most jurisdictions which provide for non-consensual rights and interests by way of maritime and other liens, hypothecs or privileges given to specific category of creditors such as crew, harbour authorities, salvors, suppliers of provisions.
- 1.2.7. This was partly addressed in article 39 which provides that a contracting state may declare those categories of non-consensual right or interest which under that State's law have priority over an interest in an object equivalent to that of the holder of a registered international interest and which shall have priority over a registered international interest.<sup>1</sup>
- 1.2.8. These areas give a flavour of some of the challenges which would need to be addressed in developing a Shipping Protocol to Cape Town. They have not been considered by the IWG, as being outside its terms of reference. Some further and tentative observations are made in Section 4 below.

### **1.3. *The scope and nature of the Questionnaire:***

1.3.1. The IWG set about drafting an extensive questionnaire which was circulated to all the 52 National Maritime Law Associations. Given the nature of the subject matter it was considered imperative that the questionnaire be as extensive as possible. A copy of the Questionnaire is being attached to this paper as Annex 1. As can be seen questions ranged from whether the jurisdiction has ratified applicable maritime conventions to what rights does the ship's register in that jurisdiction confer, to the formalities of the registration of a mortgage, to the procedures for the enforcement of a mortgage, to information relating to security interests in ships, and to general enforcement issues.

1.3.2. Up to now the following 21 countries have replied to the questionnaire:

Argentina, Australia, Brazil, Canada, Croatia, Finland, France, Germany, Greece, Ireland, Italy, Japan, Malta, The Netherlands, New Zealand, Nigeria, Norway, Panama, Spain, Switzerland and the United Kingdom.

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<sup>1</sup> This has given rise to numerous questions including what would therefore be the point in such a convention extending to ships if states could enter these caveats.

## **2. Some wider background issues and developments**

### **2.1 The state of the shipping industry and developments in the market**

- 2.1.1. The 10 years following the financial crisis of 2008 have seen a deep and widespread downturn in almost all sectors of the international shipping market. Some sectors have been affected worse than others. Different sectors have not necessarily been affected at the same time. The steep decline in oil prices which began in 2014 has resulted in the offshore oil services industry also being in considerable distress.
- 2.1.2. Chapter 11 of the United States Bankruptcy Code has been the formal insolvency proceeding of choice for shipping companies seeking protection from their creditors (including secured lenders), with the US courts liberally extending jurisdiction to companies with slim connections to the US.<sup>2</sup> Chapter 11 is seen as unfavourable by some ship financiers but not by all. Many lenders view it favourably, especially US banks and private equity funds to whom it is familiar. This is especially the case in relation to pre-packaged or pre-negotiated Chapter 11 proceedings, as opposed to "free-fall" filings. There have been other noteworthy formal insolvency proceedings in other jurisdictions, including Korea Line and Hanjin in Korea. In the Chapter 11 proceedings involving the Taiwanese company TMT the Court in Houston granted the application of the mortgagee in requesting the court to agree to a lifting of the stay order for the purposes of proceeding with a Court approved private sale in Malta. Acute distress has occurred in the German KG market, which has not resulted in Chapter 11 filings and has mainly been resolved informally or through German liquidation process.
- 2.1.3. There have also been numerous work-outs of different types which have not involved formal insolvency proceedings. These can range from simple debt rescheduling to fleets of vessels being transferred into new ownership at the instigation of mortgage lenders, with varying degrees of co-operation from the distressed shipowner. Such matters are sometimes reported in the trade press, but many are not. Anecdotal evidence is that the number of shipping companies which have been involved in out of court work-outs or restructurings of one type or another is substantial.
- 2.1.4. Financiers who have faced defaulting situations have handled their situations differently. Some have opted for the full enforcement process culminating in judicial sale proceedings whilst others have opted for out of court work-outs or restructurings.
- 2.1.5. It is possible to speculate that a number of factors have contributed to a financier's chosen course of action:
- Mortgagee lenders have been reluctant to recognise the losses which would be crystallised on a court sale in a very depressed market, without a mortgagee or mortgagee – supported bid at a level sufficient to avoid a low sale price.
  - Where lenders are prepared to accept losses, they have often preferred to sell loans (and loan portfolios) to exit problems rather than deal with problem loans directly. In any event banks have been under intense regulatory pressure to reduce exposure to shipping, especially when vessel values are below the level of bank debt.

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<sup>2</sup> See for example Marco Polo Seatrade BV, Re Case No 11-13364 (Bankr SDNY 27 September 2011).

- Many mortgagee lenders are unwilling or unable to bid or support bids by third parties and, where local law requires it, are especially averse to the double-funding risk arising from paying the auction price into court before receiving proceeds back. This issue is exacerbated where local procedure results in a potentially lengthy period to establish priorities of competing claims before proceeds are distributed.
  - The alternative of moving vessels into new ownership through exercise of mortgage self-help (private sale) remedies<sup>3</sup> where the law of the mortgage permits this or consensually with the co-operation of the shipowner can sometimes be a more attractive alternative albeit a risky exercise since in most jurisdictions it would be permissible for creditors to follow the vessel and seize the vessel irrespective of the sale. (Lenders have generally been increasingly wary of using self-help remedies in view of the risk-averse nature of credit committees.)
  - If levels of trade debt are not high as a percentage of vessel value there is less of a compelling need to cleanse vessels of debt through a court sale.
  - For a court sale to provide a successful outcome for a mortgagee it needs to take place in a suitable jurisdiction. Putting a vessel through a court sale in the 'wrong' jurisdiction can be disastrous in terms of amount and timing of recovery by the mortgagee.
- 2.1.6. These factors do not detract from the importance of ship mortgages but merely mean that they are not invariably enforced through court sale. Even where a mortgagee is prevented from pro-actively taking enforcement steps through being stayed in debtor-friendly insolvency proceedings (most notably in Chapter 11) its mortgage still gives it the enhanced rights of a secured creditor in the applicable proceedings. Where a mortgage gives the mortgagee self-help remedies it can be used to transfer ownership without putting the ship through a court sale; even if the mortgage is not expressly used for this purpose the possibility of its use can be a factor in achieving the shipowner's cooperation to a work out involving change of ownership.
- 2.1.7. In the meantime, the landscape for secured ship lending has been re-shaped since 2008 by a number of factors, which are all symptoms of an industry facing the combination of a trading downturn and the constraints suffered by financial institutions after 2008:
- A significant de-leveraging, with lending levels generally being 50/60% of vessel values rather than the 75% (or more) seen before 2008.
  - A reduction in speculative ordering of new buildings by shipping companies, combined with and in part promoted by a reduction in the willingness of financiers to support such ordering.
  - Increasing reliance on ECA-backed financing, which has in part filled the funding gap caused by banks' decreased appetite for shipping risk. ECAs are by nature conservative providers of credit.
  - The increasing role played by non-bank providers of funds, both debt and equity, especially private equity houses of different types and appetites.
  - Overall, a reduction in the availability of conventional finance.

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<sup>3</sup> Or sometimes but more rarely enforcing security over shares in a SPC ship owning company.

## 2.2. The Brazilian case of the FPSO OSX3

Some alarm was caused in 2014 by the case involving the Liberian-registered FPSO OSX3 in Brazil. The Brazilian courts (at first instance and on initial appeal) refused on various grounds to recognise the Liberian mortgage. The case brought into sharp focus issues of recognition and enforcement of foreign mortgages in Brazil and caused many to wonder whether similar problems could arise in other jurisdictions, in view of the relatively small number of countries which have acceded to the ship mortgage recognition conventions. The case was quite swiftly overturned on appeal to the Superior Court of Justice in Brasilia in 2017 and the foreign mortgage was recognized as valid in Brazil.

## 2.3. The growth of (Chinese) ship leasing.

There has been one further and very significant development in the last decade which has provided an alternative to traditional mortgage-secured ship finance: the growth of leasing, specifically by the leasing arms or subsidiaries of Chinese banks. Whilst financing of ships by way of lease is by no means new<sup>4</sup> the growth of Chinese leasing adds a new dimension. Ships leased by way of a Chinese lease are often but not always mortgaged by the leasing company to secure its own financing, either at inception of the lease or subsequently by way of 'back-financing'. The recent growth of ship leasing has led to legislative changes being introduced by two of the major flag states – the Marshall Islands in 2014 and Liberia in 2018. These changes allow a charter which is reclassified under applicable law as a security interest granted by the charterer/lessee in favour of the registered owner/lessor<sup>5</sup> to be given the status of a preferred mortgage in favour of the latter

## 2.4. The CMI Draft Convention on the International Recognition of Judicial Sales.

- 2.4.1. An important part of this discussion is the progress made by the CMI on the draft convention on the International recognition of judicial sales. It was Professor Henry Li of the China Maritime Law Association who drew attention to the fact that there were increasing problems arising around the world from the failure in some jurisdictions to give recognition to judgments in other jurisdictions ordering judicial sales. This of course led to a great deal of uncertainty amongst mortgagees in particular.
- 2.4.2. An International Working Group was created with a view to carrying out research on the extent of the problem, what the implications were and to work on a draft convention.
- 2.4.3. Data was obtained by the IWG indicating that between 2010 and 2014 more than 480 ships were sold by way of judicial sales each year just in 4 Asian jurisdictions alone – the Republic of Korea, China, Singapore and Japan.

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<sup>4</sup> Leasing of ships can be incentivised by tax advantages, although this has been cut back or closed off in most of the jurisdictions where it was once common. The Japanese operating lease (or "JOLCO") is a significant product but has been eclipsed in volume by Chinese leasing.

<sup>5</sup> These legislative changes have been driven principally by the risk to lessors of reclassification of a finance lease as a security interest, most notably in US Chapter 11 bankruptcy proceedings; see *In re Lykes Bros. S.S.Co., Inc.*, 196 B.R.574 (Bankr – M.D. Fla. 1996). Their efficacy in this context is thought to be so far untested.

- 2.4.4. An important tenet of any judicial sale is that the vessel is sold free and unencumbered to the buyer who purchases the vessel clean from any pre-existing debt. This ensures that buyers come forward to bid and pay a price reflecting the fact that the vessel does not carry with it all its previous debts. The higher the price the better for all the creditors and ultimately her owner. However, this "rule" which is respected by a number of jurisdictions worldwide, is not universally applied.
- 2.4.5. When a judicial sale by auction ordered by a competent court is not recognised in another jurisdiction this causes huge obstacles to the smooth operation of international trade. The new buyer, the mortgagees of the new buyer, the vessel's new registry and a host of other important links in the maritime chain face substantial losses and above all uncertainty.
- 2.4.6. All of this led to the CMI Draft International Convention on Foreign Judicial Sales of Ships and their Recognition which was done in Beijing in 2012, but not concluded until after further meetings in Dublin and in Hamburg in 2013 and 2014.
- 2.4.7. The draft convention, a copy of which is attached to this paper as Annex 2 contains 10 articles which provide inter alia:
- a. For a system of notification of the sale of the ship to the Registrar of the ship's register, all holders of any registered mortgage, all holders of any maritime lien and the owner of the ship.
  - b. That the vessel is sold free and unencumbered and that any title to and all rights and interests in the ship existing prior to its judicial sale shall be extinguished and that any mortgage shall cease to attach to the ship
  - c. That there is issued a certificate of judicial sale by the competent authority in the state where the judicial sale is held and for the deregistration and registration of the ship.
  - d. That all state parties shall recognise a judicial sale conducted in any other state for which a certificate would have been issued as being the sale of a vessel free and unencumbered and that where a ship sold in a judicial sale is arrested for a claim arising prior to the judicial sale, such a court shall dismiss such an arrest.
  - e. The CMI then embarked on a mission to persuade an international organisation to take up the project and take it up to an international convention.
- 2.4.8. Part of the process was the organisation of a Colloquium held in Malta in February of 2018 by the CMI and the Malta Maritime Law Association fully supported by the Government of Malta.
- 2.4.9. The Malta Colloquium was a huge success attended by 174 participants from 60 countries representing ship owners, financiers, tug operators, suppliers of provisions, the International Transport Federation (ITF), BIMCO, the Institute of Chartered Ship brokers (ICS), and the Federation of National Associations of Ship Brokers and Agents.
- 2.4.10. There was support across the board for the absolute need for more certainty in this important area of international trade. There was much emphasis by a leading ship financier who shared the views of another 11 major banks that there was need to provide international certainty through the creation of an international convention.

- 2.4.11 Lenders emphasised how the shipping market was volatile and in light of additional uncertainties banks attempted to circumvent the problems by searching for amicable solutions very frequently adding to the cost. It was underlined that without a reliable international basis for the recognition of judicial sales of vessels buyers would need to be satisfied with risks when obtaining the title, which would drive down the sale price.
- 2.4.12 The deliberations and conclusions of the Malta Colloquium led to a Proposal from the Government of Switzerland to UNCITRAL on possible future work on cross-border issues related to judicial sale of ships. The Proposal contained a resume of the deliberations at the Malta Colloquium which clearly underlined the need for certainty in such an important aspect of international trade.
- 2.4.13 The Swiss proposal was put on the Agenda for the fifty first session of the General Assembly at UNCITRAL. The Swiss delegation was represented by Prof. Alex von Ziegler who presented the proposal supported by Stuart Hetherington and Ann Fenech on behalf of the CMI. There were several other proposals presented to the General Assembly. However the Swiss Proposal for possible future work on cross-order issues related to the judicial sale of ships received a great deal of support from a number of countries including India, Australia, Argentina, Columbia, Singapore and China. BIMCO was very supportive stating in a letter that: ***"At its recent meeting in New York, BIMCO's Documentary Committee decided that BIMCO representing shipowners worldwide but also working in the interest of other parties engaged in the maritime transport chain should lend its support to the proposal by Malta and Switzerland of a possible future work on cross border issues related to the judicial sales of ships. While the proposal clearly strives towards the unification of maritime law and practices in respect of the judicial sales of ships, BIMCO believes that it brings along concrete benefits for the shipping industry such as legal certainty."*** UNIDROIT represented by the Secretary General ***"commended the excellent proposal of CMI."***
- 2.4.14 UNCITRAL noted that the issue had the potential to affect many areas of international trade and commerce, not simply the shipping industry and agreed that priority in the allocation of working time should be given to the topics of judicial sale of ships and issues relating to expedited arbitration and that the judicial sale of ships should be allocated to the first available working group.
- 2.4.15 This has therefore cleared the way for much greater peace of mind for those financiers who decide to go down the route for enforcement proceedings through the judicial sale of a vessel. Such a convention will ensure that financiers will obtain the best possible price for such vessels sold in these forced circumstances because such sales transferring title free and unencumbered will be recognised by all state parties. This will therefore give more confidence to ship financiers when extending facilities to owners of vessels.

## 2.5. Academic and other interest in the topic

Whether or not the Cape Town Convention should have a Shipping Protocol has been the subject matter of several publications.

We are attaching hereto a number of articles which all put a different perspective on things.

**Francesco Berlingieri's** article on "News from Unidroit" attached as Annex 3.

In his paper Prof Berlingieri highlights a number of important considerations including:

- a. What would be the relationship between the national registry and the international registry given that no financier will take the risk of registering his interest solely in the international register?
- b. What would be the relationship between the registered charges and the non registerable consensual rights of so many maritime service providers including crew, suppliers of provisions and port authorities?
- c. How would the enforcement of claims actually work in the event that there are so many other non consensual rights?
- d. Would such a protocol not add even more problems rather than eliminate them?

**Dr. Ole Böger** from the Ministry of Justice in Germany presented the Case for a new protocol to the Cape Town Convention covering security over ships at the 5th Annual conference of the Cape Town Convention Academic Project in Oxford in September 2016, attached as Annex 4.

In his paper Dr. Böger highlights the following:

- a. He underlines what in his view is the unsatisfactory legal framework especially regarding differences between the legal systems concerning the use and status of proprietary security in cross border business
- b. He expresses concern on whether and under which conditions these consensual proprietary security rights would be recognised under a foreign law.
- c. He acknowledges however that with some exception, most legal systems have reformed their law so they now provide for the recognition of ship mortgages and hypothecs where the requirements are fulfilled.
- d. He believes that too many jurisdictions do not follow this same rule when it comes to deciding on priority between claims leading to uncertainty
- e. He believes that all of these difficulties would be overcome were there to be a protocol extended to shipping.

**John Bradley**, partner at Vedder Price spoke on "Cape Town Convention for Ships – A solution in search of a problem" at the 17<sup>th</sup> Annual Marine Money Greek Ship Finance Forum – October 2015 – attached as Annex 5.

In his presentation he made these observations:

- a. Whether current cross-border ship-finance practices are satisfactory and if not, whether the international harmonization of those practices through Cape Town provides a better working solution.
- b. Whether Cape Town can do for ship finance what it has done for aviation finance by lower borrowing costs and increased financing opportunities
- c. Whether ship finance has a problem in need of a Cape Town Solution or is Cape Town a solution in search of a ship finance problem.

- d. That academics see crossover benefits for ship finance and that aviation finance professionals are satisfied with Cape Town and the aircraft protocol
- e. That the marine sector however is sceptical due to the growth in size and sophistication of the top 7 registries worldwide, the very problematic issue surrounding non consensual rights and that the actual remedies under Cape Town give rise to several complications.

**Dr. Vincent Power** – Partner at A & L Goodbody gave a presentation alongside Dr. Ole Böger on "Assessing the Legal and Economic case for a shipping protocol" to the Cape Town Convention at the 5<sup>th</sup> Annual conference of the Cape Town Convention Academic Project in Oxford in September 2016, attached as Annex 6.

He raised the following issues:

- a. Would a shipping protocol to the Cape Town Convention help resolve some of the difficulties and challenges in shipping finance and, if it would resolve such issues, would the protocol be adopted, ratified, enter into force and be implemented or used by sufficient number in the sector to make a real difference?
- b. That the challenge in "joining the dots" between the shipping protocol to Cape Town and the somewhat chaotic tapestry of international maritime conventions should not be underestimated.
- c. Whilst the difficulties as they exist particularly with the different ways in which priorities are dealt with in different jurisdictions as the rationale for the creation of a shipping protocol to Cape Town, ironically these difficulties are also one of the barriers to the adoption of such a protocol.
- d. That it is possible that a shipping protocol would resolve many of the issues involved in the maritime sphere in theory but it may not do so in practice.

### 3. Responses to the Questionnaire

3.1. Responses have so far been received from NMLAs in the following countries:

Argentina  
Australia  
Brazil  
Canada  
Croatia  
Finland  
France  
Germany  
Greece  
Ireland  
Italy  
Japan  
Malta  
The Netherlands  
New Zealand  
Nigeria  
Norway  
Panama  
Spain  
Switzerland  
United Kingdom

This is 21 out of the 52 NMLAs contacted. There are some responses outstanding from some important jurisdictions, including China and the United States.

3.2. The responses so far are attached as Annex 7 (a), Annex 7(b) and Annex 7 (c), sorted on a question by question basis. Some observations on the responses are made below. At some risk of subjectivity, over-simplification or over-generalisation these observations are deliberately kept brief and are more by way of executive summary than a detailed analysis

#### Question 1 – Maritime and other conventions

- The responses reflect the relatively wide ratification of the 1952 Arrest Convention and the limited ratification of the 1999 Arrest Convention.
- In any event a mortgagee generally has a right to arrest. This applies not only to vessels registered in the arrest jurisdiction but also to mortgages of foreign vessels.
- The responses reflect the low level of ratification of the 1926 Maritime Liens and Mortgages Convention and the lack of traction of the 1993 Convention.
- Foreign maritime liens are widely recognised in one way or another (but see further Question 11).

#### Question 2 – Nature of the ships' register

- Not all ships' registers are registers of title and even where they are they are not always conclusive as to title.

- Some jurisdictions have more than one register, and for different purposes.
- The ability to register as a bareboat charterer ('bareboat charter registration in') so as to fly the flag of the bareboat charter register (with title remaining registered in the name of the owner on the 'underlying register', with entitlement to fly the flag of that register suspended) is common but not universal. It is not common to be able to note on the bareboat charter register the existence of a mortgage on the underlying register.
- Some but not all registers allow 'bareboat charter registration out', i.e. the ability of an owner to allow a bareboat charterer to register a ship on, and fly the flag of, a different register from the underlying register, with the entitlement of the owner to fly the flag of the underlying register suspended (i.e. the converse of 'bareboat charter registration in').
- Registers which allow bareboat charter registration in do not necessarily allow bareboat charter registration out, and vice versa.
- The test for what is capable of registration as a 'ship' varies from jurisdiction to jurisdiction. In many countries it is open to interpretation whether assets used in the offshore industry – which have developed since the applicable legislation and rules were written – are capable of falling within or without the registration requirements. Most jurisdictions do not expressly deal with these types of assets.<sup>6</sup>

### Question 3 – Formalities and mortgage registration

- It is not common for full copies of underlying loan documentation to be required to be attached to the mortgage, although sometimes important terms of the documentation (such as events of default) need to be set out in this mortgage.
- *Ad valorem* registry fees by reference to the amount secured are not uncommon but are usually not in an amount which is prohibitive.
- Registration is indefinite (i.e. does not require periodic renewal) in all but a few jurisdictions.
- It is unusual for registration of the mortgage to be required in a register in addition to the ships' register.<sup>7</sup>
- It is noteworthy that in Australia ship mortgages are not registrable in the ships' register but in the Personal Property Securities Register.

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<sup>6</sup> Two exceptions are Nigeria and Norway which expressly provide for the registration of FSOs and FPSOs. In practice many types of such assets which are not 'ships' in the traditional sense are known to be registered on a variety of different registers. The litigation in Brazil in relation to the Liberian registered FPSO *OSX3* (see paragraph 2.2 above) was a local law challenge to the registration of such assets notwithstanding the approval of the law of the register. The Superior Court of Justice overturned two lower court decisions which did not give effect to the mortgage.

<sup>7</sup> This is, however, the case in the UK and certain other common law jurisdictions such as Ireland and Nigeria which have a 'company charges' registration regime. Further registration is also required in Spain. The position in Canada is complicated.

#### Question 4 – Information concerning security interests in ships

- It is almost universal for information to be publicly available.
- There are differences in the procedure for obtaining information and the time taken to obtain the results of a search.
- Many jurisdictions allow a sale of a ship which is subject to a mortgage, sometimes subject to the mortgagee's consent – but in all cases in private sale scenarios, the mortgage survives in the new ownership.

#### Question 5 – Arrest of a chartered ship

- There is generally nothing to prevent a mortgagee from arresting a ship which is on charter.
- It is rare for a mortgagee to be liable to a charterer for wrongful interference (or similar) with the charter – but in some jurisdictions such liability can arise if the arrest is wrongful or abusive (or similar).
- Very few jurisdictions have express provisions relating to the discharge of cargo from arrested vessels.

#### Question 6 – Priority issues between mortgages registered in the ships' register in your jurisdiction

- A minority of jurisdictions provide for a 'priority notice' system which allows priority to be 'reserved' in advance of registration of a mortgage.
- Consent of an existing mortgagee is generally not required for the registration of a subsequent mortgage.
- Priority between mortgages is almost invariably determined by the time of registration.<sup>8</sup>
- It is rare for a registered mortgage to be deferred to a previous unregistered mortgage on the basis of a doctrine of notice, or equivalent.
- Generally, a subsequent mortgagee does not require the consent of a prior mortgagee to enforce its security.<sup>9</sup>
- It is relatively rare for interests other than mortgages to be capable of registration.

#### Question 7 – General enforcement issues

- Most jurisdictions do not distinguish between local and foreign mortgages as regards enforcement.

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<sup>8</sup>In Greece mortgages registered on the same day have the same priority and rank *pari passu*.

<sup>9</sup>This is of course subject to any contractual agreement to the contrary.

- Obtaining a judgment against the shipowner is necessary in some jurisdictions. In some cases this can take years.
- Most countries accept jurisdiction based either on the 1952 Arrest Convention Article 7 or equivalent domestic legislation.

#### Question 8 – Judicial decisions and appeals

- Specialist admiralty courts are relatively uncommon.
- Procedures for sale vary and can be delayed by intervention/appeal by the shipowner.

#### Question 9 – Sale procedure

- Sale by court auction (or court sale by tender) is almost universally available. A judgment for the debt is often required before sale.
- Most jurisdictions have some concept of sale *pendente lite* (i.e. before judgment) this may be in the discretion of the court and require it to be established that the ship is a wasting asset.
- Most jurisdictions fix a minimum bid price, by one means or another.
- Some jurisdictions allow the shipowner and/or creditors to intervene in the fixing of the minimum bid price.
- Most sales are publicised locally, but more rarely internationally.
- The shipowner can influence the timetable of the sale process in a number of jurisdictions.
- Court approved private sale (as distinct from court auction or tender) is relatively rare – and in some jurisdictions requires the agreement of the shipowner.
- The ability of a mortgagee to bid its debt (*animo compensandi*) rather than having to pay cash or provide security for the full price is possible in a number of jurisdictions.

#### Question 10 – Sale proceeds

- Most sales take place in local currency, or with a requirement to convert the price into local currency.
- The sale proceeds generally bear interest at a low rate.
- Exchange control or similar restrictions on payment out of sale proceeds are relatively rare.
- Court or admiralty marshals' fees vary.<sup>10</sup>

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<sup>10</sup>Note the court duty fee of 10% of the sale proceeds in Ireland.

### Question 11 – Priorities generally

- Priorities are variously determined by the *lex fori*, the *lex causae* or the *lex registri*.<sup>11</sup> A large number of jurisdictions apply the *lex fori*.
- The claims (i.e. maritime liens) having priority over a mortgage vary from jurisdiction to jurisdiction.
- The priority position of a mortgage vis-à-vis other claims is generally not affected by whether the mortgage is local or foreign to the *lex fori*.
- It is rare for preferential treatment as regards priority to be given to local creditors.<sup>12</sup>
- There is wide divergence in respect of procedure and timing for distribution of sale proceeds.
- Rights of appeal are common.

### Question 12 – Mortgagee's self-help remedies

- Self-help remedies only tend to be available in common law jurisdictions, as opposed to civil law jurisdictions.
- A security power of attorney in favour of a mortgagee is allowed in a few jurisdictions which otherwise do not generally allow self-help remedies.
- There is variance on whether jurisdictions of enforcement allow self-help remedies which are alien to its law but are permitted by the law of the flag.

### Question 13 – Insolvency processes

- The UNCITRAL Model Law on Cross-Border Insolvency has been adopted in six of the twenty one countries which have responded so far.
- The 'Recast' EU Insolvency Regulation applies in EU countries.
- Otherwise, the position on recognition of foreign insolvency proceedings is diverse.
- There is wide variation on whether mortgage enforcement is stayed where there are insolvency proceedings and whether mortgage enforcement is generally deferred to insolvency proceedings (or *vice versa*) – but a stay or suspension is common in one form or another.
- Reflecting the diverse position on recognition of foreign insolvency proceeding generally (where the UNCITRAL Model Law or the EU Insolvency Regulation do not apply) there is a correspondingly diverse position on giving effect to a foreign insolvency stay.

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<sup>11</sup>And sometimes by a combination, as in Greece.

<sup>12</sup>Port authorities etc. which are owed money frequently have super-priority treatment however.

- 'Clawback' in the context of specified pre-insolvency transactions is common in one form or another.
- Even where the UNCITRAL Model Law or the EU Insolvency Regulation do not apply a 'universalist' approach claiming insolvency jurisdiction over worldwide assets is not uncommon.

#### Question 14 – Leasing

- In some jurisdictions leasing only appears to be common in relation to small vessels and/or is not common.<sup>13</sup>
- The responses indicate approaches that vary widely from jurisdiction to jurisdiction as regards a formal approval or functional (re-characterisation) approach to leasing. There does not appear to be a clear division of approach depending on whether a jurisdiction is a civil law or a common law jurisdiction. There are, not surprisingly, indications from some responses that the treatment and approach depends on the terms of the lease and that there might be a distinction between a finance lease (or equivalent) and an operating "true" lease (or equivalent), with only the former being characterised as a security interest.
- In Australia and New Zealand the relationship between the PPSA regime and the regime for registration of ship mortgages merits further investigation.
- The responses so far indicate that it is common for rights and remedies of the lessor to be capable of being expanded by contract but some jurisdictions appear to adopt a more restricted approach.
- Some jurisdictions prohibit exercise of self-help remedies but others permit it - but not surprisingly only if the lease contract so provides.
- The majority of responses are to the effect that a leased vessel is an asset of the lessor. It would be expected that this would be the case in jurisdictions that adopt a formal approach.<sup>14</sup>
- In a few jurisdictions a lessee (as bareboat charterer) is treated at least for some purposes as having a proprietary interest.
- The responses from a few jurisdictions note the distinction between legal treatment and accounting treatment.

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<sup>13</sup> No response has yet been received from China. Leasing by leasing companies affiliated with Chinese banks has become a very major source of finance in the last few years as noted in paragraph 2.3 above. Further, although not responding countries, also as referred to in paragraph 2.3 above it is known that the Marshall Islands and Liberia have amended their laws to enable a charter which might be vulnerable to re characterisation as a security interest to be registered as a deemed mortgage granted by the charterer in favour of the registered owner.

<sup>14</sup> But this is also the position in Australia and New Zealand, where a functional approach is taken by virtue of statute. The responses to this question were surprisingly unequivocal.

- As regards the effect of lessee insolvency on the rights and remedies of the lessor, the majority of responses are consistent with the lessor having rights and remedies of an owner. This is to be expected in jurisdictions which adopt a formal approach and where the vessel is an asset of the lessor. Some jurisdictions give some optionality to the lessee (or its bankruptcy official) to terminate or continue the lease. Many of the responses on whether the answer is affected by the type of lease are not explicit.
- The responses from a number of jurisdictions are to the effect that a lessor, being owner of the vessel, cannot arrest its own asset. Other jurisdictions indicate no conceptual issue about a lessor arresting its own vessel.<sup>15</sup>
- A number of jurisdictions indicate that in one way or another a lessor takes subject to maritime liens/claims - on the basis that the lessor is the owner of the vessel rather than a party with a claim against the owner of the vessel.
- On whether there is generally a wish to promote leasing the responses were negative from ten countries, lukewarm from two countries and positive from four countries.

#### Question 15 – Reservation of title

- The position is diverse amongst jurisdictions.
- Generally there are no special registration regimes for registration of title arrangements.<sup>16</sup>

#### Question 16 – Insurance proceeds

- Most but not all jurisdictions give a mortgagee an interest in insurance proceeds by operation of law.

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<sup>15</sup> The response from Croatia refers to a lessor having a right to arrest, and to join in arrest by third parties, provided it has a maritime claim - but without elaborating what a maritime claim is in this context. The response from Ireland is similar.

<sup>16</sup> But the position already noted in the Marshall Islands and Liberia on registration of charters is relevant in this context.

#### 4. Some tentative conclusions

- 4.1. What picture emerges, and what conclusions can be drawn, from the responses so far to the questionnaire? It is necessary to bear in mind that a number of responses are so far lacking; also, the nature of the questions and that they have been addressed to NMLAs. The questions are deliberately neutral in tone and address issues of law. The questionnaire is not a wide ranging survey of industry participants. Against this background some points are tentatively made as follows.
- 4.2. The findings are generally what one might expect, with few surprises. The picture which emerges is diverse and disjointed but not dysfunctional. Most jurisdictions recognise and give effect to ship mortgages by one means or another. In particular, foreign ship mortgages are widely recognised.<sup>17</sup> However, by its nature the questionnaire does not reveal the extent to which practical difficulties or delays may be encountered.
- 4.3. To the extent that the responses so far indicate shortcomings it seems that these are not essentially issues of international recognition of rights as between different jurisdiction but, rather, the effects of domestic law or procedure.
- 4.4. It is not within the International Working Group's terms of reference expressly to consider whether there should be a Shipping Protocol to the Cape Town Convention. However, in view of the material which has been published on this issue in the last few years<sup>18</sup> it seems appropriate to make some observations.
- 4.5. There is as yet no sign of pressure from financiers to develop a Shipping Protocol. This contrasts with the strong aviation industry pressure (from both manufacturers and financiers) which led to the development of the Cape Town Convention and the Aircraft Protocol.
- 4.6. To our knowledge no interest either has been shown in the subject matter by any of the major shipping organisations, including ICS, BIMCO, FONASBA, or the Institute of Chartered Shipbrokers.
- 4.7. The shipping and ship finance industries have long been accustomed to ship registration performing a dual function: registration for operational and flagging purposes; and registration for property and mortgaging purposes. This duality of purpose is reflected in most jurisdictions. The position with aircraft was less well established as regards property and mortgaging, leading to the perceived need for Cape Town and the Aircraft Protocol.<sup>19</sup>
- 4.8. The dual purpose of ship registrations is however not set in stone. The practice of bareboat registration separates the operational and flagging functions from the property and mortgaging functions.<sup>20</sup> A Shipping Protocol to Cape Town would add another regime dealing exclusively with a new type of international interest. It would co-exist alongside the existing

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<sup>17</sup> As already noted the concern caused by the *OSX3* case in Brazil has subsided after the two lower court decisions which did not recognise a Liberian mortgage were overruled by the Superior Court of Justice.

<sup>18</sup> See paragraph 2.5 above.

<sup>19</sup> The unsatisfactory treatment of property rights in aircraft under English conflict of laws rules is illustrated by the 'Blue Sky' litigation: *Blue Sky One Ltd v Mahan Air* [2009] EWHC 3314 (Com Ct); [2010] EWHC 631 (Com Ct).

<sup>20</sup> The position in Australia should also be noted. Ship mortgages are registered in the Personal Property Securities Register rather than the ship register.

ship registers in the same way that the Cape Town regime for aircraft co-exists alongside domestic aircraft registers.<sup>21</sup>

- 4.9. Developing a Shipping Protocol for Cape Town would be a major and time-consuming undertaking.<sup>22</sup> In order to stand any chance of success it would need to side-step any attempt to create conformity on treatment of maritime liens, i.e. the issue which has been the stumbling block to the success of the Maritime Liens and Mortgages Conventions. This alone is likely to raise numerous questions given the extent of important privileges enjoyed by non-consensual right holders.
- 4.10. One potential advantage would be to remove the 'bankability' issue around some registers and some enforcement jurisdictions. The ability to take a Cape Town international interest might be attractive to financiers of a ship registered on a flag which does not give satisfactory remedies to a mortgagee and/or which is operating in an unfavourable enforcement jurisdiction.<sup>23</sup> This is something about which industry views will need to be canvassed.
- 4.11. The recent and rapid growth in the financing of ships by leasing from Chinese leasing companies and anecdotal evidence of an increase in other sale and leaseback transactions introduce an important dimension to the debate which should be factored into the continuing process.
- 4.12. It is suggested that the next steps would be for the Executive Council to approve the following:
  - 4.12.1. To complete the current survey by seeking responses from key jurisdictions which have not yet responded; and
  - 4.12.2. After that, through the NMLAs, take soundings from industry sources to ascertain whether or not there is any dissatisfaction at all with the status quo or whether, if there is such dissatisfaction, the extent of it
- 4.11.3 With the responses of the questionnaires in hand, to open the matter up to a wider group for further discussion.

This document was prepared for your consideration by the International Working Group on Ship Finance Security Practices.

16<sup>th</sup> October 2018

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<sup>21</sup> It is common for aircraft financiers to take both a Cape Town international interest and a mortgage in the applicable domestic aircraft register. The relationship between a mortgage registered on a conventional ship register and a Cape Town interest would need to be carefully addressed.

<sup>22</sup> It has been suggested that the task might be too great and that a more manageable and fruitful task would be to develop Cape Town Protocols for containers or for offshore oil and gas assets which are not typical 'ships'. It is understood that the fourth Protocol on the Mining, Agricultural and Construction (MAC) Equipment that UNIDRIOT is now working on diverges from the Aircraft Protocols to a greater extent than either the Protocols on Space Assets and Railway Rolling Stock. Thus a Shipping Protocol would need to be drafted to reflect the specific nature of the complex shipping industry. This will increase the time and cost necessary for drafting.

<sup>23</sup> The major 'open' ship registers provide bankable mortgages so might see this potential benefit of a Shipping Protocol as a commercial threat.