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To cite this article: Ole Böger (2016) The case for a new Protocol to the Cape Town Convention covering security over ships, Cape Town Convention Journal, 5:1, 73-102, DOI: [10.1080/2049761X.2016.1256432](https://doi.org/10.1080/2049761X.2016.1256432)

To link to this article: <https://doi.org/10.1080/2049761X.2016.1256432>



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Published online: 22 Nov 2016.



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# The case for a new Protocol to the Cape Town Convention covering security over ships

Ole Böger\*

*The Cape Town Convention on International Interests in Mobile Equipment is one of the most successful international conventions in the field of private law. The harmonisation and modernisation of the regime for secured transactions concerning the classes of mobile assets of high value covered by the Convention and the Protocols thereto confers substantial economic advantages for market participants in the Contracting States, especially through a stronger and more reliable position for the secured creditor which in turn leads to an increase in the availability of financing and to a reduction of its costs. This article argues that there is a clear case for extending this regime for secured transactions to ships through the preparation of a new Protocol to the Cape Town Convention covering security over ships. The business of shipping finance is in crisis and the extension of the Cape Town Convention system would be a suitable solution to many of the major legal obstacles currently encountered in the shipping finance market in cross-border transactions, especially through the reduction of the risk of non-recognition of ship mortgages or hypothecations under a foreign law of the flag or through a more efficient harmonised system of registration and priorities. Previous attempts at legal harmonisation in this field of law have not been successful: the Cape Town Convention system, however, with its core features of an international proprietary interest and a system of registration in a single uniform international register can be expected to find more support, also by avoiding the highly contentious issue of maritime liens, i.e. non-consensual security over ships.*

## Introduction

The 2001 UNIDROIT Convention on International Interests in Mobile Equipment (hereinafter ‘Cape Town Convention’) is regarded as being one of the most ambitious and successful international conventions in the field of private law.<sup>1</sup> In general, international legal harmonisation in the area of private law, specifically in the law of property, is a notoriously

slow and difficult process and it often proves impossible to reach a broad international consensus which bridges the differences between states from different legal traditions and with different levels of socio-economic development.<sup>2</sup> The Cape Town Convention, however, has been able to attract widespread support worldwide, among its 72 State Parties are high-income economies, newly industrialised countries as well as developing countries and it includes countries from different legal

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<sup>1</sup> Roy Goode, ‘The priority rules under the Cape Town Convention and Protocols’ (2012) 1 Cape Town Convention Journal 95.

<sup>2</sup> Mark Sundahl, ‘The “Cape Town Approach”: A New Method of Making International Law’ (2006) 44 Columbia Journal of Transnational Law 339, 341. See also Charles Mooney, ‘The MAC Protocol: some comments and a challenge’ (2015) 4 Cape Town Convention Journal 76, noting that with the exception of the success of the Cape Town Convention system, international efforts to harmonise secured transactions law have encountered many obstacles.

backgrounds, whether civil law countries, countries from the common law world or others.<sup>3</sup>

With its unified, asset-based system of registration for mobile assets of high value, the Cape Town Convention has set an international standard for the regime of proprietary security in this type of assets. This standard is respected also under other international instruments developed by other international organisations, such as the UNCITRAL Legislative Guide on Secured Transactions.<sup>4</sup>

In the view of this immense success, it is perhaps somewhat surprising that the Cape Town Convention so far does not cover ships as one of the most obvious and most common examples of mobile assets of high value. This is even more so given the fact that while the market for secured finance in shipping is enormous,<sup>5</sup> this market is traditionally riddled with difficulties stemming to a large extent from an unsatisfactory legal framework especially as regards differences between the legal systems concerning the use and status of proprietary security in cross-border business, i.e. legal difficulties that are typically regarded as providing arguments for legal harmonisation.<sup>6</sup> In fact, in the very early stages of the

development of the project that was to become the Cape Town Convention, the possibility of covering security over ships had indeed been contemplated its drafters.<sup>7</sup> However, that idea was put aside already before the diplomatic conference in Cape Town took place.<sup>8</sup> It was argued then that the preparation of international rules governing ships and shipping was traditionally the preserve of specific international organisations with full participation of shipping circles. Moreover, there was concern about possible conflict with an already existing international instrument, namely the International Convention on Maritime Liens and Mortgages that was adopted only shortly before at the 1993 Geneva Conference of the United Nations (UN) and the International Maritime Organization.

However, 20 years later the time has now come for a reassessment of the legal and economic case for a new Protocol to the Cape Town Convention covering security over ships. The business of shipping finance is in crisis<sup>9</sup> and other attempts to solve the problems

<sup>3</sup> Convention on International Interests in Mobile Equipment <http://www.unidroit.org/status-2001capetown>.

<sup>4</sup> See the recommendation 4(a) of the UNCITRAL Legislative Guide on Secured Transactions, which exempts mobile assets covered by the Cape Town Convention from scope the application of the Guide, <[https://www.uncitral.org/pdf/english/texts/security-1g/e/09-82670\\_Ebook-Guide\\_09-04-10English.pdf](https://www.uncitral.org/pdf/english/texts/security-1g/e/09-82670_Ebook-Guide_09-04-10English.pdf)> accessed 21 September 2016.

<sup>5</sup> The current global shipping financing market is reported to have a volume of US\$80 to 90 billion, see OECD Council Working Party on Shipbuilding, Workshop on Supply and Demand in the Shipbuilding Industry, <[https://www.oecd.org/sti/ind/Item%202.%20HDA%20Conseil\\_%20Impact%20of%20Ship%20Financing\\_Final.pdf](https://www.oecd.org/sti/ind/Item%202.%20HDA%20Conseil_%20Impact%20of%20Ship%20Financing_Final.pdf)> accessed 21 September 2016.

<sup>6</sup> José María Alcántara, 'A Short Primer on the International Convention on Maritime Liens and Mortgages (1996) 27 Journal of Maritime Law and Commerce 219, 232; Ole Böger, 'The Cape Town Convention and Proprietary Security over Ships' (2014) 19 Uniform

Law Review 59; Roy Goode, 'Battening down your security interests: How the shipping industry can benefit from the UNIDROIT Convention on International Interests in Mobile Equipment' [2000] Lloyd's Maritime and Commercial Law Quarterly 161, 174; George Lord and Garrard Glenn, 'The Foreign Ship Mortgage' (1947) 56 Yale Law Journal 923, 940; Charles Haight, 'Babel Afloat: Some Reflections on Uniformity' (1997) 28 Journal of Maritime Law and Commerce 189, 195; Panayotis Sotiropoulos, 'Liens for Necessaries and Arrest of Ships under Greek Law' (1988) 12 Tulane Maritime Law Journal 299, 311.

<sup>7</sup> See Article 2(1)(c) of the first set of draft articles of a future UNIDROIT Convention on Interests in Mobile Equipment, March 1996, UNIDROIT document Study LXXII – Doc. 24.

<sup>8</sup> This criticism has been summarised in a memorandum issued by the UNIDROIT Secretariat, see UNIDROIT 1996, Study LXXII – Doc. 29. See also Paul Larsen and Juergen Heilbock, 'UNIDROIT Project on Security Interests' (1999) 64 Journal of Air Law and Commerce 703, 724.

<sup>9</sup> Okan Duru, 'The Ship Mortgage Crisis' (2014) <<http://www.maritime-executive.com/article/The-Ship-Mortgage-Crisis-2014-10-23>> accessed 21 September 2016. See also the report in The Economist Newspaper, 'Profits Overboard' (issue 10 September

stemming from the diversity of the regimes of maritime proprietary security, including the aforementioned 1993 Geneva Convention have not been successful.<sup>10</sup> Meanwhile, the idea to extend the Cape Town Convention to security over ships had never been fully forgotten and not only has it been repeatedly argued for in the academic literature<sup>11</sup> as well as – increasingly – by practitioners in the market,<sup>12</sup> but also the relevant international organisations are appearing to resume their interest in a Protocol on Ships. The preparation of such an additional Protocol to the Cape Town Convention has been included, even if with a rather low priority as compared to other ongoing projects, in the current work programme of UNIDROIT.<sup>13</sup> In this context, a preliminary study on the feasibility of such a project has been presented to the UNIDROIT Governing Council in 2013,<sup>14</sup> and that study suggested that further research into this topic would be advisable. As of yet, UNIDROIT has not taken additional formal steps towards the preparation of a Draft Protocol and is still monitoring developments in this area, especially concerning the degree of industry support and the suitability of alternative approaches to current problems in shipping

finance. The Comité Maritime International has also taken an interest in this issue. In 2014, it has set up a Working Group on Ship Financing Security Practices<sup>15</sup> which, however, has not yet taken a definite position on this issue but is currently undertaking preparatory work collecting data and information on current financing practices in the various shipping jurisdictions.<sup>16</sup>

The objective of this Paper is to assess whether a case exists for such a new Protocol to the Cape Town Convention covering security over ships. Such an assessment requires an analysis of the existing legal situation, of any relevant particularities of the business sector concerned and of the suitability of the Cape Town Convention model as compared to other possible solutions, such as action on a national level or the reliance on existing international instruments. As succinctly put by Professor Sir Roy Goode, the questions to be asked when considering the drafting of a new international instrument are: Is there a problem? Is there a feasible solution? And is the project likely to receive a substantial measure of support not only from governments but from industry and other interested sectors?<sup>17</sup>

### **The present system of the Cape Town Convention and the Protocols thereto and its possible extension to ships**

#### ***The Cape Town Convention and the existing and possible future Protocols thereto***

The Cape Town Convention system, as it stands now, comprises the Cape Town Convention itself, which sets out the general principles of this system's secured transactions

2016), available online under <<http://www.economist.com/news/business/21706556-shipping-business-crisis-industry-leader-not-exempt-profits-overboard>> accessed 21 September 2016.

<sup>10</sup> See below *sub E*.

<sup>11</sup> Goode (n 6) 161; Böger (n 6) 59.

<sup>12</sup> Watson Farley and Williams <<http://www.wfw.com/wp-content/uploads/2016/06/WFW-Briefing-Brazil-Non-Brazilian-Mortgages-Offshore-Assets-.pdf>> accessed 21 September 2016. The prevailing view amongst practitioners still appears to be sceptical, see John E. Bradley, 'Cape Town Convention for Ships: A Solution in Search of a Problem?' <<https://www.marinemoney.com/sites/marinemoney.com/files/John%20Bradley.pdf>> accessed 21 September 2016.

<sup>13</sup> 2013 UNIDROIT General Assembly Report, A.G. (72) 9, at 6 and 20.

<sup>14</sup> 2013 UNIDROIT Governing Council document, C.D. (92) 5 (c)/(d). For an update see the 2016 UNIDROIT Governing Council document, C.D. (95) 13 Add. 4 rev.

<sup>15</sup> <<http://www.comitemaritime.org/Ship-Financing-Security-Practices/0,27150,115032,00.html>> accessed 21 September 2016.

<sup>16</sup> <[http://www.comitemaritime.org/Uploads/Correspondence\\_President/Ship%20Finance%20security%20practices%20questionnaire%20final.pdf](http://www.comitemaritime.org/Uploads/Correspondence_President/Ship%20Finance%20security%20practices%20questionnaire%20final.pdf)> accessed 21 September 2016.

<sup>17</sup> Roy Goode, 'From Acorn to Oak Tree: The Development of the Cape Town Convention and Protocols' (2012) 19 Uniform Law Review 599, 600.

regime for mobile assets of high value, and the different Protocols to the Convention. The Cape Town Convention is not a stand-alone instrument and it can be applied to any type of mobile equipment only if this type of equipment is covered by one of the sector-specific Protocols to the Cape Town Convention. The following three Protocols have already been adopted: the 2001 Protocol to the Convention on International Interest in Mobile Equipment on Matters specific to Aircraft Equipment, which has attracted 65 Contracting Parties<sup>18</sup> and is therefore the most successful Protocol under the Cape Town Convention system by far; the 2007 Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Railway Rolling Stock;<sup>19</sup> and the 2012 Berlin Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Space Assets.<sup>20</sup> The latter two have not yet come into force.

With these three Protocols, the Cape Town Convention system is now complete as regards all three categories of objects specifically enumerated in the Cape Town Convention itself, i.e. aircraft industry assets (airframes, aircraft engines and helicopters), railway rolling stock and space assets.<sup>21</sup> However, the Convention envisaged the extension of the Cape Town Convention to objects of other categories of high-value mobile equipment through additional Protocols to be prepared by specific working groups created by UNIDROIT in cooperation with the relevant international organisations of that sector.<sup>22</sup> Currently, the work programme of UNIDROIT includes

three additional Protocols. Work has already advanced on the preparation of a possible fourth Protocol to the Cape Town Convention on Matters specific to Agricultural, Construction and Mining Equipment.<sup>23</sup> A Study Group produced a Draft text for this Protocol over four meetings in 2014–2016<sup>24</sup> and the Governing Council of UNIDROIT has decided in May 2016 that a Committee of Governmental Experts should be convened on this issue in 2017.<sup>25</sup> Work on the other two possible Protocols is still in its early stages: Apart from the work on a Protocol on ships, there is also the project of a Protocol on renewable energy equipment where the UNIDROIT Secretariat is currently intending to prepare a feasibility study.<sup>26</sup>

### *The function of the individual Protocols within the Cape Town Convention system*

Each of the existing individual Protocols to the Cape Town Convention has a double function and the same would apply to any future Protocols. Such Protocols are not only necessary as instruments that provide for the application of the Cape Town Convention to the category of objects covered by the respective Protocols, but they also contain sector-specific rules, amending the general rules of the Cape Town Convention according to the needs of the different industry sectors.<sup>27</sup> Such rules might even go beyond the scope of the issues originally envisaged for the

<sup>18</sup> <<http://www.unidroit.org/status-2001capetown-aircraft>> accessed 21 September 2016.

<sup>19</sup> The Luxembourg Rail Protocol has so far been ratified only by Luxembourg and the European Union, <<http://www.unidroit.org/status-2007luxembourg-rail>> accessed 21 September 2016.

<sup>20</sup> The Berlin Space Protocol has not yet been ratified by any State <<http://www.unidroit.org/status-2012-space>> accessed 21 September 2016.

<sup>21</sup> Cape Town Convention, art 2(3).

<sup>22</sup> Cape Town Convention, art 51(1).

<sup>23</sup> On the topic of the development of this draft Protocol see Henry Gabriel, 'The MAC Protocol: we aren't there yet – how far do we have to go?' (2015) 4 Cape Town Convention Journal 67; Marek Dubovec, Charles Mooney and William Brydie-Watson, 'The mining, agricultural and construction equipment protocol to the Cape Town Convention project: The current status', (2016) 21 Uniform Law Review 332.

<sup>24</sup> See the information on the UNIDROIT project website <<http://www.unidroit.org/work-in-progress-studies/current-studies/mac-protocol>> accessed 21 September 2016.

<sup>25</sup> See UNIDROIT 2016 C.D. (95) Misc 2, para 7.

<sup>26</sup> See the information on the current work programme in UNIDROIT 2016 – C.D. (95) 13 rev, para 37.

<sup>27</sup> Cape Town Convention, art 6(2).

Cape Town Convention, as evidenced by the provisions in the draft Protocol on Matters specific to Agricultural, Construction and Mining Equipment concerning conflicts with security over immovable property.<sup>28</sup> Dividing the Cape Town Convention system into the general Cape Town Convention and the industry-specific Protocols has several important advantages, one of them being that it was possible to restrict the text of the Convention to general rules on a regime of secured transactions for mobile assets of high value. Most importantly, however, this division allowed the drafting process for each Protocol to be organised according to the needs and requirements of the market participants and relevant organisations from the respective industry sector.<sup>29</sup>

This distinction between the Cape Town Convention and the different Protocols thereto means that the extension of the Cape Town Convention system to security over ships would not entail the wholesale application of the present regime for proprietary security over, for example, aircraft under the Cape Town Convention and the Aircraft Protocol to ships. Instead, the general principles of the Cape Town Convention comprising a regime of secured transactions in respect of mobile assets of high value would be applied subject only to any amendment deemed to be necessary in relation to ships that could be agreed in the new Protocol itself.

***Outline of the secured transactions regime of the Cape Town Convention and its possible extension to ships***

By way of an outline, the Cape Town Convention's regime of secured transactions for mobile assets of high value includes the following core elements.

The most important feature of the Cape Town Convention is that it provides for an international interest,<sup>30</sup> i.e., a proprietary

interest whose creation, validity and effectiveness against third parties does not depend upon the fulfilment of any requirements under the secured transactions regimes of national law or upon any conditions for the recognition of foreign security interests.<sup>31</sup>

Publicity of international interests in mobile equipment, i.e. ensuring that interested parties can obtain reliable information concerning the existence of such encumbrances, is paramount under the Cape Town Convention. The Convention provides for a system of publicity by registration in an international register specifically to be established for this purpose<sup>32</sup> and that operates as a real folio system<sup>33</sup> and is accessible for searching purposes to the general public in an electronic format.<sup>34</sup> Registration in this international register is determinative of the priority status of the international interest<sup>35</sup> and is required for the effectiveness of the international interest in insolvency proceedings against the debtor.<sup>36</sup>

As regards the priority status of competing international interests and other security rights under national law in the same assets, the Cape Town Convention lays down a clear system of priorities. Registered international interests have priority over any unregistered security, especially security under national law; as between competing international interests, priority is determined according to the order of the time of the respective registration in the international register.<sup>37</sup>

Strengthening the position of the creditor in the enforcement of the security against the debtor is another main objective of the Cape Town Convention system,<sup>38</sup> both within and

<sup>31</sup> On the decision against earlier suggestions to follow a recognition-based approach see Goode (n 17) 602.

<sup>32</sup> Cape Town Convention, art 16(1).

<sup>33</sup> Cape Town Convention, art 22(2).

<sup>34</sup> Cape Town Convention, art 22(1).

<sup>35</sup> Cape Town Convention, art 29(1).

<sup>36</sup> Cape Town Convention, art 30(1).

<sup>37</sup> Cape Town Convention, art 29(1).

<sup>38</sup> See generally Thomas Traschler, 'The Cape Town Convention's remedies: path to harmonisation'

<sup>28</sup> Sixth Annotated Draft of the MAC Protocol, UNIDROIT 2016 – Study 72K – SG4 – Doc 6, art VII.

<sup>29</sup> Goode (n 17) 603 s.

<sup>30</sup> Cape Town Convention, art 7.



outside the context of insolvency proceedings. In the event of the debtor's default, the creditor may have recourse to a harmonised set of remedies, including self-help remedies,<sup>39</sup> and appropriation of the collateral in satisfaction of the secured obligation is encouraged.<sup>40</sup> Concerning the creditor's rights in the context of insolvency proceedings, the Cape Town Convention system provides for several options (or 'Alternatives') that seek to accommodate differing national insolvency law approaches with the general aim of ensuring that even in the event of insolvency, the insolvency administrator should at least in general not be allowed to prevent the creditor from taking possession of the collateral after a certain waiting period has lapsed.<sup>41</sup>

In the aircraft sector, i.e. the only sector where the regime of the Cape Town Convention is already in operation, it has been recognised through academic studies that the application of these principles has a hugely beneficial overall economic effect<sup>42</sup> and this is reflected in the Aircraft Sector Understanding of the Organisation for Economic Cooperation and Development (OECD), which allows export credit agencies to charge lower premiums on the financing provided to buyers or lessees that are located in Contracting States to the Cape Town Convention and the Aircraft Protocol.<sup>43</sup> By virtue of a possible Protocol on

ships, these general rules of the Cape Town Convention could then be applied to security over ships as well. It will be considered below whether and to which extent the problems and risks that are currently encountered in the market for shipping finance<sup>44</sup> could be satisfactorily answered by the application of these rules,<sup>45</sup> so that corresponding economic benefits could be expected for the shipping sector as well. As indicated above, an extension of the Cape Town Convention system to ships would not necessarily entail a wholesale application of the Cape Town Convention rules as applied, e.g. to aircraft. Instead, a possible Protocol on ships could take into account the specific needs and peculiarities of the market for shipping finance, deviating from and amending these general rules as deemed necessary for this specific sector. While no decision has yet been taken by the relevant international organisations on whether formal negotiations on a possible Protocol on ships should be commenced, this article will suggest some issues to be considered in the drafting of such an instrument,<sup>46</sup> reflecting the existing legal framework and peculiarities of the shipping finance sector.

### Major legal problems concerning proprietary security over ships in cross-border transactions

Shipping finance is a business that is rarely purely domestic. Even where the financing transaction as such involves only parties from one jurisdiction, the ship itself is likely to move from one jurisdiction to another in the course of its commercial operation. Thus, even where a ship financing transaction has been concluded domestically, it could become necessary to enforce any proprietary security rights over the

[2016] Butterworths Journal of International Banking and Financial Law 399.

<sup>39</sup> Cape Town Convention, art 8(1).

<sup>40</sup> Cape Town Convention, art 9.

<sup>41</sup> Alternatives A and B in art IX of the Aircraft Protocol and art XXI of the Berlin Space Protocol, Alternatives A, B and C in art IX of the Luxembourg Rail Protocol, see Dubovec, Mooney and Brydie-Watson (n 23), 339 s.

<sup>42</sup> Anthony Saunders, Anand Srinivasan and Ingo Walter, 'Innovation in International Law and Global Finance: Estimating the Financial Impact of the Cape Town Convention' available at SSRN <<https://ssrn.com/abstract=894027>> accessed 21 September 2016.

<sup>43</sup> See OECD, Sector Understanding on Export Credits for Civil Aircraft, Doc TAD/ASU <[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=tad/asu\(2011\)1&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=tad/asu(2011)1&doclanguage=en)> accessed 21 September 2016.

<sup>44</sup> See 'Major legal problems concerning proprietary security over ships in cross-border transactions' below.

<sup>45</sup> See 'How the extension of the Cape Town Convention system to ships would solve current issues concerning proprietary security over ships in a cross-border context' below.

<sup>46</sup> See 'Some specific issues to be considered in the drafting process' below.

ship which the secured creditor has obtained under such a domestic transaction while the ship is within the jurisdiction of foreign courts. As will be shown below, however, virtually every aspect of the law of proprietary security over ships may give rise to significant risks and complexities once a cross-border element is involved. The following overview will show the main topics where differences as between the various national legal orders worldwide give rise to legal risks for secured creditors and other participants in the shipping finance market; the (limited) effects of existing international instruments intended to overcome these problems will be considered below.

### ***Recognition of ship mortgages and hypothecations under foreign law***

A primary concern for secured creditors holding (or considering obtaining) ship mortgages or hypothecations in cross-border business is whether and under which conditions these consensual proprietary security rights (i.e. proprietary security rights created on the basis of an agreement of the parties) would be recognised under a foreign law.

In the absence of any international instrument providing for proprietary security over ships as an international interest, ship mortgages or hypothecations are currently created and made effective, usually by registration, under the rules of the applicable national law only. Generally, the question whether the various legal systems allow the creation of consensual proprietary security rights over a ship under their national law and permit, if required, the registration of these proprietary interests in the national shipping register is governed by the rule of the law of the flag.<sup>47</sup> This means that each State will allow the creation and registration of security over ships under its national legal system if the ship flies the flag of the State concerned, i.e., if ownership of the vessel is registered in that State.

<sup>47</sup> Philip Wood, *Comparative Law of Security and Title Finance* (2<sup>nd</sup> edn, Sweet & Maxwell 2007) paras. 39-073.

### ***Widespread application of the law of the flag as governing law for the recognition of foreign ship mortgages and hypothecations***

The question is then for secured creditors whether this creation and registration of their security rights under the law of the flag can reliably be expected to be recognised before the courts of another State. This might especially become relevant if the ship is arrested in another jurisdiction and proceedings are brought before the courts of that State. As a general matter, the acceptance or recognition of foreign property interests, especially if created or perfected under the requirements of foreign law or if providing different or more extensive rights than are known under the relevant domestic property law, is traditionally one of the most complicated issues of private international law. The widespread prevalence of a reference to the law of the *situs* of the collateral concerned as a principle of international property law in general is evidence of the reluctance of national property law regimes to accommodate the application of foreign property law and to recognise the existence and effects of proprietary interests under foreign law.<sup>48</sup>

As concerns the recognition or acceptance of consensual security over ships, however, the application of the law of the *situs* has been to a large extent replaced by an application of the rule of the law of the flag. It is a widespread practice among legal systems worldwide that the law of the flag is not only applied for the creation of security rights over ships under domestic law but that also the question of the valid creation and third party effectiveness of foreign security rights over ships is to be governed by the law of the State where ownership of the vessel is registered.<sup>49</sup> Such a reference to the

<sup>48</sup> Hans Stoll, in *Staudingers Kommentar zum Bürgerlichen Gesetzbuch* (Sellier 1996) Int SachenR paras 124 ss.

<sup>49</sup> For a general overview, see Sergio Carbone, 'Conflicts de Lois en Droit Maritime' (2010) 340 *Recueil des cours* 63, 253. See also, for instance, the situation in China: Maritime Code of 1993, art 271



law of the flag would in principle be sufficient to provide certainty for the market participants as concerns the applicable law for the creation and third party effectiveness of proprietary security rights over ships in a cross-border context.<sup>50</sup> Secured creditors can rely on the recognition of their proprietary security even before foreign courts as long as the requirements for the valid creation and third party effectiveness of the security under the law of the flag are fulfilled.

*Exceptions: jurisdictions that traditionally do not unreservedly apply the rule of the law of the flag*

However, given the fact that, as stated above, the recognition of foreign security interests in general is an area that is highly in dispute, it is probably not surprising that regardless of the widespread reference to the law of the flag on this matter, there still appears to be a considerable insecurity among market participants as regards the status of proprietary security over ships under foreign law.

One important factor that contributes to this uncertainty is that there are still jurisdictions that traditionally do not, or not unreservedly, follow the rule of the flag. Even though this is a clear minority position among the jurisdictions worldwide, it cannot easily be predicted at the time of the conclusion of a security agreement providing for the use of a vessel as collateral to which jurisdictions the ship might sail during its operations. Therefore, the risk cannot be excluded with absolute certainty that an eventual dispute concerning the validity and effectiveness of the proprietary security could be brought before the courts of a State that does not unreservedly recognise ship mortgages and hypothecations under a foreign law of the flag, the jurisdiction of these courts to hear the dispute being based

(1); England: *The Angel Bell* [1979] 2 Lloyd's Rep 49; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), art 45(1) Nr 2; United States: 46 USC Section 31301(6)(B).

<sup>50</sup> Sotiropoulos (n 6) 312.

upon the arrest of the ship at its current location.<sup>51</sup>

In international scholarly legal writing, there are references to a number of jurisdictions said traditionally not to recognise foreign ship mortgages and hypothecations under the rule of the law of the flag.<sup>52</sup> Some of these legal systems have in fact, recently or earlier, reformed their law so as now expressly to provide for the recognition of foreign ship mortgages and hypothecations where the requirements for the valid creation and effectiveness of these rights under the law of the flag are fulfilled.<sup>53</sup> However, there are still jurisdictions where the application of the law of the flag cannot be unreservedly relied upon in this respect. In Argentina, for example, foreign ship mortgages and hypothecations that fulfil the requirements for the valid creation and registration under the law of the flag are recognised only if reciprocity is ensured,<sup>54</sup> i.e. if the court is satisfied that the flag State recognises ship mortgages and hypothecations under Argentinian law, which can introduce an element of uncertainty as to the reliability of the position of the secured creditor.

*Exceptions: application of the rule of the law of the flag denied by courts*

A second factor that contributes to legal uncertainty in this respect is that even in jurisdictions that were previously not presumed to be

<sup>51</sup> For the difficulties arising in relation to the unpredictability of the location of the vessel see also Lennard K Rambusch and Jovi Tenev, 'International Maritime Workouts' in *Business Workouts Manual* (2nd edn Thompson Reuters/West 2008) para 16:4.

<sup>52</sup> Wood (n 47) para 39-076, referring, amongst other jurisdictions, to the laws of Thailand, Turkey, Venezuela and the former South African province of Natal.

<sup>53</sup> See Thailand: Vessel Mortgage and Liens Act 1994, art 21; for Turkey see Code of International Private and Procedural Law 2007, art 22; Venezuela: Decreto No 1.506 of 2001 *Ley de Comercio Marítimo* (Law of Maritime Commerce), art 131.

<sup>54</sup> See Ley No 20.094/1974 *Régimen de navegación* (Shipping Act), art 600.

adverse to the application of the law of the flag as the governing law for the recognition of foreign ship mortgages and hypothecations, courts have sometimes thwarted the expectations of secured creditors holding ship mortgages and hypothecations under foreign law and decided to the contrary, i.e. they have denied the recognition of ship mortgages and hypothecations created and registered under the provisions of the law of the flag instead of the law of the forum.

One example is the New Zealand case *The 'Betty Ott'*.<sup>55</sup> In 1992, the New Zealand Court of Appeal had to decide in a case which involved a priority conflict in respect of a ship registered in Australia between an Australian registered mortgage and a later New Zealand security interest registered under the provisions of the law of New Zealand. The court held that priority between the competing security rights was to be determined under New Zealand law. For that matter, the security registered under the provisions of Australian law could not be recognised as equivalent to a domestic, i.e. New Zealand mortgage, as this security right was not registered in New Zealand (and thus not of a type recognised under New Zealand law). As a result, the later security registered in New Zealand was afforded priority over the Australian security which was treated as unregistered.

This decision has been heavily criticised in the legal literature, where it was argued that the application of this rule would potentially deprive holders of registered ship mortgages of their security under all jurisdictions except for the State of registration.<sup>56</sup> The situation in New Zealand has since been remedied on the basis of the enactment of Section 70 of the Ship Registration Act 1992.<sup>57</sup> This provision expressly provides that ship mortgages and

other security rights registered under a foreign law of the flag are recognised in New Zealand and given effect equivalent to New Zealand ship mortgages.<sup>58</sup>

A more recent example is the litigation in Brazil concerning the floating production storage and offloading unit (FPSO) 'OSX-3', a Liberian-registered vessel used in the offshore oil industry in the Brazilian exclusive economic zone.<sup>59</sup> The BTG Pactual Banco S/A sought to recover USD 28 million as an unsecured creditor from OSX 3 Leasing B.V., a Dutch company who was the owner of the OSX-3. This claim was contested by the Nordic Trustee ASA as the holder of a registered Liberian ship mortgage over the OSX-3 who argued that any attempt by BTG Pactual Banco S/A to enforce its claim against the OSX-3 before the Brazilian courts would have to respect the priority of Nordic Trustee's rights under this foreign registered mortgage. Brazil is a party to the 1926 Brussels Convention on Maritime Liens and Mortgages<sup>60</sup> and to the 1928 Bustamante Code,<sup>61</sup> which both provide for the recognition of ship mortgages under foreign law, and this at least appeared to indicate that

<sup>58</sup> Concerns whether this principle should also apply to security rights over ships of less than 24 meters length, in relation to which there is no registration requirement under the Ship Registration Act 1992 and which are also not excluded from the scope of the New Zealand Personal Property Securities Act 1999 (see Section 23 (e)(xi)) have been alleviated by the New Zealand High Court decision in the case *KeyBank National Association v The Ship Blaze* [2007] 2 NZLR 271, where it was held that the registration of a security under foreign law is to be recognised in such situations as well, see Geoff Brodie, 'Personal Property Securities: A New Zealand Maritime Law Perspective' (2008) 22 A&NZ Mar LJ 22.

<sup>59</sup> I.e. the sea area beyond and adjacent to a coast state's territorial waters with a breadth of 200 nautical miles from the coast baseline, see the 1982 United Nations Convention on the Law of the Sea, arts 55 ss.

<sup>60</sup> See 'Existing international instruments on proprietary security over ships and their lack of success' below.

<sup>61</sup> Ernest Lorenzen, 'The Pan-American Code of Private International Law' (1930) 4 Tulane Law Review 499.

<sup>55</sup> *The Ship 'Betty Ott' v General Bills Ltd* [1992] 1 NZLR 655.

<sup>56</sup> Paul Myburgh, 'Recognition & Priority of Foreign Ship Mortgages: *The Betty Ott*' [1992] Lloyd's Maritime and Commercial Law Quarterly 155, 158

<sup>57</sup> William Tetley, 'Maritime Liens, Mortgages and Conflict of Laws' (1993) 6 University of San Francisco Maritime Law Journal 1, 40.

Brazil would follow this rule as a general principle. However, on 3 February 2016, a Sao Paulo Appeals Court held that Nordic Trustee's Liberian ship mortgage would not be recognised as a valid mortgage in the Brazilian proceedings, and this judgment was upheld in an appellate decision of 1 June 2016. The court argued that ship mortgages registered under a foreign law would be regarded as effective only if there was a binding treaty between Brazil and the flag law State concerning the reciprocal recognition of ship mortgages or if there was shown to be international customary law that recognises the validity of the foreign mortgage in Brazil. The court held that the fact that Brazil is a party to the 1926 Brussels Convention and to the Bustamante Code is not relevant since Liberia is not a signatory to either of these Conventions and therefore reciprocity is not ensured. As regards the existence of a rule of international customary law providing for the recognition of ship mortgages under a foreign law of the flag, the court held that there was not sufficient evidence for the existence of such a rule.

This decision is a cause for immense concern for secured creditors since the recognition and status of ship mortgages under a foreign law of the flag now must be regarded as being no longer secured whenever proceedings in relation to a vessel are brought before the Brazilian courts, unless the flag State is a party to the 1926 Convention or the Bustamante Code. It has been suggested that vessels currently registered in Liberia could be re-flagged to Panama which is a party to the Bustamante Code in order to ensure the recognition of ship mortgages registered under the law of the flag in Brazil.<sup>62</sup> This solution, however, would obviously cause considerable costs and may not be feasible in every case,<sup>63</sup> especially

<sup>62</sup> CMS Cameron McKenna (*CMS Law-Now*, 13 June 2016) <<http://www.cms-lawnow.com/ealerts/2016/06/ship-mortgages-in-brazil-continuing-uncertainty-for-secured-creditors>> accessed 21 September 2016.

<sup>63</sup> See, generally, Dmitri Pentsov, 'Maritime Liens, Rights of Retention, and Mortgage of Vessels under

in view of the fact that the choice of register for a ship also governs the safety regulations, labour laws and other rules under which the ship is operated.<sup>64</sup>

The decision in the OSX-3 case is a strong reminder that, at least in the absence of clear statutory provisions on the recognition of foreign maritime security rights, courts may deny the validity and effectiveness of ship mortgages and hypothecations under a foreign law of the flag even in jurisdictions that previously were understood as following the principle of the application of the rule of the law of the flag as regards the recognition of ship mortgages and hypothecations under a foreign law. If this decision is not reversed by the Superior Tribunal de Justiça, a similar reasoning could arguably even be applied in other Latin American jurisdictions that are party to the Bustamante Code.

### ***Priority of consensual proprietary security over ships***

Apart from the question of the recognition of foreign ship mortgages and hypothecations, there is also a need for certainty as regards the priority status of competing consensual proprietary security rights over ships in cross-border transactions. The value of a ship mortgage or hypothecation as a proprietary security for the secured creditor's claim is obviously to a large extent determined by its priority status. Even where there are no doubts as to the recognition of a proprietary security over a vessel, a secured creditor who has advanced credit in reliance on this interest might effectively be deprived of its security where a competent court subsequently holds that under the applicable rules of priority a competing security right under another law takes precedence over that interest. As regards the issue of the priority status of consensual proprietary security rights over ships in a cross-border situation, secured creditors face the double problem that there are still considerable

the Legislation of the Russian Federation', (2002) 26 *Tulane Maritime Law Journal* 609.

<sup>64</sup> United Nations Convention on the Law of the Sea, art 94.

differences as regards the rules on priority of consensual proprietary security over ships under the various jurisdictions worldwide<sup>65</sup> and that there is no international consensus on the determination of the applicable law for these issues of priority.<sup>66</sup>

### *Differences in the rules on priority of consensual proprietary security over ships*

To the extent that national law provides for the registration of consensual proprietary security over ships such as ship mortgages or hypothecations in a national register,<sup>67</sup> most legal systems are in agreement that as a general starting point, the order of priority as between such registered security rights is to be determined according to the order of registration.<sup>68</sup> However, this general rule is subject to several exceptions where there is no unanimity among jurisdictions worldwide.

First, some details of the priority rules concerning consensual security over ships vary as between different legal systems. Some legal systems, for example, provide that rights registered at the same date have equal ranking.<sup>69</sup> In other legal systems, the order of priority is determined by the order of registration, giving rights registered at the same date, but before other rights, priority over the latter.<sup>70</sup> Another issue concerns forms of provisional

or advance registration. Such measures are allowed in some legal systems, but there is, for example, no unanimity as to the length of the period of time for which a priority position can be secured under such a registration.<sup>71</sup>

Secondly, some legal systems provide that regardless of the order of registration, consensual security interests acquired by a secured creditor which knew or should have known of the existence of earlier security interests cannot take priority over those earlier security interests.<sup>72</sup>

Thirdly, and most importantly, some legal systems have specific priority rules under which foreign consensual security interests over ships are generally treated less favourably than domestic security rights. The non-recognition of foreign security rights which has been dealt with in the preceding section is obviously the most evident case of a disadvantageous treatment of foreign security rights. Other legal systems, however, do not regard foreign ship mortgages or hypothecations as ineffective, but assign them to a lower priority position than domestic security rights. A prime example is US law, where foreign ship mortgages enjoy the same ranking as equivalent domestic interests (i.e. US preferred ship mortgages) only if they are guaranteed under the Federal Ship Financing Program.<sup>73</sup>

<sup>65</sup> See 'Differences in the rules on priority of consensual proprietary security over ships' below.

<sup>66</sup> See 'Divergent conflict-of-laws rules on priority of consensual proprietary security over ships' below

<sup>67</sup> See 'Registration of ship mortgages and hypothecations in ship registers under national law' below.

<sup>68</sup> Cf. the endorsement of this principle in the UNCITRAL Legislative Guide on Secured Transactions (2007), Chapter IV, para 3 (p 149); see also Ulrich Drobnig and Ole Böger, *Proprietary Security in Movable Assets (PEL Prop. Sec.)* (Sellier and Oxford University Press 2015) 457.

<sup>69</sup> See Sweden: *Sjölag* 1994 (Maritime Code), Ch 3, sec 12; see also Norway: *Lov om sjøfarten* 1994 (Maritime Code), sec 23(2).

<sup>70</sup> See Argentina: *Ley no. 20.094/1974 Régimen de navegación* (Shipping Act), art 504; England: Merchant Shipping Act 1995, sch 1, para 8(1); Germany:

*Schiffsregistergesetz* (Ship Register Act), § 25(1); New Zealand: Ship Registration Act 1992, sec 40(1).

<sup>71</sup> See England: the Merchant Shipping (Registration of Ships) Regulations 1993, reg 59, allows the registration of a (renewable) notice by an intending mortgagee which has the effect of securing the priority position if the mortgage is registered within 30 days; under the law of Panama, such a priority position can be secured for 6 months, see *Ley del Comercio Marítimo* 2008 (Maritime Commerce Act), art 252.

<sup>72</sup> See Norway: *Lov om sjøfarten* 1994 (Maritime Code), sec 24(1).

<sup>73</sup> Merchant Marine Act 1936, title XI, see 46 USC Chapter 537 and 46 USC sec 31326(b)(2); William Tetley, 'Arrest, Attachment, and Related Maritime Law Procedures' (1999) 73 *Tulane Law Review* 1895, 1931; Alexandra Mandaraka-Sheppard, *Modern Maritime Law* (Volume 1, Informa 2013) 190.

*Divergent conflict-of-laws rules on priority of consensual proprietary security over ships*

Given these differences among the legal systems worldwide as to the rules on the priority status of competing consensual proprietary security rights over ships, it would be very much in the interest of secured creditors holding such security interests in cross-border situations if there was at least no lingering uncertainty as to the determination of the legal regime under which the priority position of the security interest is to be decided. However, there is no such unanimity and the various legal systems worldwide appear to be divided in two groups following opposite approaches on this issue. Many legal systems apply the same conflict-of-laws rule that predominantly determines the status of consensual proprietary security over ships, i.e. they decide issues of priority as between consensual security over ships according to the law of the flag.<sup>74</sup> Other jurisdictions, however, do not share this view. Emphasising the procedural role of the determination of priority in the process of enforcing security rights, the law of the forum is applied and there is no submission to the application of any foreign law of the flag.<sup>75</sup> While the

former conflict-of-laws rule can at least provide some certainty and predictability for the secured creditor as regards the applicable regime for the determination of the priority status as between consensual security rights, the rule on the application of the law of the forum has the effect that it cannot be predicted at the moment of the conclusion of the security agreement which priority rules will be applied in an eventual dispute which might be brought before a foreign court exercising jurisdiction over the vessel on the basis of the arrest of the ship at its current location.

***Issues concerning the requirements of registration in registers under national law***

Current international legal thinking on the law of proprietary security puts strong emphasis on the existence of a system of registration that provides publicity for the existence of consensual proprietary security rights.<sup>76</sup> Secured creditors shall be able to make their security interests known to the public and prospective secured creditors and buyers shall be able to rely on the content of a public register as regards the existence of prior security rights, protecting them against the risk of the existence of silent security rights that would take precedence over any proprietary interests to be acquired by the prospective secured creditors and buyers. At the same time, a system of publicity by registration should not operate in a manner that is unduly burdensome. An efficient system of registration should allow for a simple and reliable way of obtaining information about existing security rights and there should be a clear and simple registration process, which in

<sup>74</sup> See, for instance, Norway: *Lov om sjøfarten* 1994 (Maritime Code), sec. 75(2) No 1; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), art 45(1) Nr 2; *Karl Kreuzer, Die Vollendung der Kodifikation des deutschen Internationalen Privatrechts*, (2001) 65 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 383, at 455; for a contrary view see *Christiane Wendehorst*, in: *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (5th ed, Beck 2010), art 45 EGBGB para 81, arguing that the law of the location of the ship, which is decisive for determining the priority status of non-consensual security rights (see *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), art 45(2) sent. 2 *juncto* art 43(1), should also govern the priority status of consensual security rights in order to avoid conflicts that might otherwise arise in the event of two different priority regimes being applied in situations where there are several non-consensual and consensual security rights. For similar concerns under Greek law see *Sotiropoulos* (n 6) 314.

<sup>75</sup> See, for instance, Argentina: *Ley* no 20.094/1974 *Régimen de navegación* (Shipping Act), art 600 (under the

condition that the reciprocity requirement is fulfilled and the foreign interest is recognised in Argentina); Canada: *Todd Shipyards Corp v Altema Compania Maritima SA (The Ioannis Daskalelis)* [1974] SCR 1248; England: *The Colorado* [1923] p 102; Greece: see the case law referenced by *Sotiropoulos* (n 6) 312; New Zealand: *Ship Registration Act* 1992, sec 70. This approach is also favoured in the general treatise by *Carbone* (n 49) 255 s.

<sup>76</sup> See UNCITRAL Legislative Guide on Secured Transactions (2007), Chapter IV, paras 1 and 29 (pp 103, 110); *Drobnig* and *Böger* (n 68) 433.



turn should lead to a decrease in the costs and effort required and to a reduction of the risk of an inadvertent failure to comply with registration requirements. Presently, the legal situation as regards publicity requirements for ship mortgages and hypothecations in cross-border situations does not entirely fulfil either of these requirements.

### *Registration of ship mortgages and hypothecations in ship registers under national law*

Under most national legal systems, ship mortgages and hypothecations can become effective against third parties in general (often referred to as perfection of the security)<sup>77</sup> only upon fulfilment of a requirement of publicity, usually by means of registration.<sup>78</sup> Such a registration of consensual proprietary security interests over ships usually takes place in the title register for the vessel concerned, i.e. a ship register under national law<sup>79</sup> (whether a national ship register<sup>80</sup> or an open register<sup>81</sup>). A search of such an asset-based register

<sup>77</sup> Drobniġ and Böger (n 68) 397; for US-American law see Uniform Commercial Code (UCC) secs 9–301 ss.

<sup>78</sup> Wood (n 47) para 28–009.

<sup>79</sup> See, for instance, England: Merchant Shipping Act 1995, sch 1, para 7; France: Pierre Bonassies and Christian Scapel, *Droit Maritime* (2nd ed., L.G.D.J, 2010) 385; Philippe Simler and Philippe Delebecque, *Les sûretés* (6th ed., Dalloz 2012) 657; Germany: *Schiffsregistergesetz* (Ship Register Act), §§ 8 and 3; Turkey: Kerim Atamer, ‘New Turkish Law on Ship Finance’ in Orestis Schinas, Carsten Grau and Max Johns (eds), *HSBA Handbook on Ship Finance* (Springer 2013) 201, 206; United States: 46 USC sec 31321(a)(1).

<sup>80</sup> I.e. a ship register under national law that is restricted to domestically-owned ships. Increasingly, States operate two ship registers, the second (or international) ship register applying no restrictions on the nationality of the crew and lower safety standards compared to the first register and not necessarily being restricted to domestically owned ships, see, for instance, Germany: §§ 2 and 12 *Flaggenrechtsgesetz* (German Flag Act); Norway: Robert Kappel, *The Norwegian international ship register* (Bremen Institute of Shipping Economics and Logistics 1988).

<sup>81</sup> I.e. a ship register under national law that allows the registration of foreign-owned ships (subject to the existence of a requirement of a ‘genuine link’ as

should retrieve all registered information concerning each individual vessel, especially on the identity of the owner and on all registered consensual security rights such as ship mortgages or hypothecations over this vessel. A notable exception is the English equitable mortgage over ships which does not require registration under the Merchant Shipping Act 1995, but whose low priority status severely restricts its value as a security right;<sup>82</sup> moreover, especially for smaller ships, there is often an exemption from the requirement of registration of the ship and of any security rights created over it.<sup>83</sup>

Still, even though registration is the norm for ship mortgages and hypothecations worldwide, the process of obtaining reliable information for prospective secured creditors and buyers as regards the existence of prior security rights may especially in a cross-border context still be rather cumbersome. Interested parties may have to contact a ship register operated under foreign domestic law, sometimes there are several ship registers in the flag State<sup>84</sup> and the transition from a traditional paper-based register to electronically accessible registers sometimes is not yet fully completed.<sup>85</sup>

### *Differences concerning registration requirements and procedures under national law*

The current lack of a harmonised electronically accessible registration system for consensual

prescribed by the 1958 Geneva Convention on the High Seas, art. 5). The main examples of such ship registers under a “flag of convenience” are the ship registers of Panama, Liberia and the Marshall Islands.

<sup>82</sup> Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomicka, *The law of security and title-based financing* (2nd edn, Oxford University Press 2012) para14.37.

<sup>83</sup> Beale, Bridge, Gullifer and Lomnicka (n 82) para14.34.

<sup>84</sup> Germany: *Schiffsregisterordnung* (Ship Register Order), §§ 1 and 4.

<sup>85</sup> See, for instance, the Irish Merchant Shipping (Registration of Ships) Act 2014, which provides for the electronic operation of the ship register, but which will come into operation only at the date still to be appointed by order of the Minister for Transport, Tourism and Sport.



proprietary security rights over ships does not only make it less easy to obtain reliable information on the existence of ship mortgages and hypothecations over foreign vessels. The fact that the formal requirements to be fulfilled in order to effect the registration of a proprietary security interest over a ship vary according to the jurisdiction concerned<sup>86</sup> also adds additional complications to the registration process itself. A secured creditor intending to register its security rights in foreign registers will have to follow different registration procedures for each register concerned, which is likely to make it necessary to seek local legal advice for each different registration process. While some jurisdictions require either notarisation of the security agreement or mortgage deed<sup>87</sup> or attestation of the shipowner's signature,<sup>88</sup> other jurisdictions insist on the use of prescribed forms.<sup>89</sup> Moreover, the different national legal systems allow the application for registration to be made at different places, especially as regards the possibility of effecting a registration outside the territory of the flag State. While some jurisdictions allow applications for registration at any foreign consulate of the flag State,<sup>90</sup> others restrict such possibilities to certain consulates in the most important

port cities.<sup>91</sup> Moreover, in addition to publicity by registration, some legal systems require a copy of the mortgage document to be kept on board the ship as an additional formal requirement,<sup>92</sup> but failure to comply with this requirement does not necessarily invalidate the mortgage.

### *Security over ships and registration in general debtor-indexed registers*

Registration of proprietary security rights over ships is further complicated by the fact that in many legal systems there is not only an asset-specific ship register, but also a general debtor-indexed register for proprietary security, i.e. a register that is organised according to the name or other identifier of the security provider and that covers all (or at least most) types of consensual security rights in movable property. The classical examples of such debtor-indexed general registers for proprietary security are the English Companies Register<sup>93</sup> and the register of security interests under US-American UCC Article 9.<sup>94</sup> While there is a recognisable trend for the introduction of such registers even in legal systems that previously did not have general debtor-indexed registers for proprietary security,<sup>95</sup> there is still a number of legal systems without general debtor-indexed registers and where publicity by registration is required only as registration in specific asset-based registers for certain types of collateral such as ships or aircraft.<sup>96</sup>

<sup>86</sup> For a comparative treatment of the various formal requirements under the different legal systems worldwide see Lucy French, 'The Ship Mortgage' in Stephenson Harwood (eds), *Shipping Finance* (3rd edn, Euromoney Books 2006) 125–224; Hill Dickinson (eds), *International Ship Registration Requirements* <[www.hilldickinson.com/pdf/International%20ship%20registration%20requirements.pdf](http://www.hilldickinson.com/pdf/International%20ship%20registration%20requirements.pdf)> accessed 21 September 2016.

<sup>87</sup> See, for instance, Greece: Spyridon Vrelis, *Private International Law in Greece* (Kluwer 2011) 118; see also the requirements under the German *Schiffsregisterordnung* (Ship Register Order), § 37(1) concerning the consent of the shipowner.

<sup>88</sup> See the Norwegian *Lov om sjofarten* 1994 (Maritime Code), sec 15(2).

<sup>89</sup> See England: Merchant Shipping Act 1995, sch 1, para 7(2).

<sup>90</sup> See Panama: *Ley del Comercio Marítimo* 2008 (Maritime Commerce Act), art 250.

<sup>91</sup> See, for instance, for Greek law: Wood (n 47) para. 28–041.

<sup>92</sup> This requirement is also prescribed by the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, art 12.

<sup>93</sup> For the operation of the English Companies Register as a debtor-indexed register see Beale, Bridge, Gullifer and Lomnicka (n 82) para 10.07.

<sup>94</sup> US-American UCC, sec 9-519(c).

<sup>95</sup> See the references Drobniig and Böger (n 68) 438 ss.

<sup>96</sup> E.g. Austria and Germany, see Drobniig and Böger (n 68) 444.

In the jurisdictions with both such general debtor-indexed registers and asset-specific registers for ships, different solutions have been found to the question of how the existence of a general requirement to register all proprietary security interests in the general debtor-indexed register should affect the registration requirements for ship mortgages and hypothecs. In some legal systems, a secured creditor is only required to comply with the registration requirements concerning the asset-specific ship register, security over ships being specifically exempted from the scope of the security interests that are registrable in the general debtor-indexed register.<sup>97</sup> This precedence of registration in the asset-specific register over a general debtor-indexed register is also favoured by current international legal thinking on proprietary security in movables.<sup>98</sup> Nevertheless, the legal systems of several other important shipping jurisdictions still require proprietary security rights over ships to be registered both in the asset-specific register and in the general debtor-indexed register. In some of these legal systems, registration in the debtor-indexed register alone determines the third party effectiveness of the security in general, especially in the event of insolvency, while registration in the asset-specific register provides protection against loss of priority vis-à-vis competing security interests.<sup>99</sup> A few legal systems have even

entirely replaced the registration of ship mortgages in the asset-specific ship register by registration in the general debtor-indexed register.<sup>100</sup>

### *Different remedies under existing proprietary security rights*

The typical consensual proprietary security rights over ships that are currently available to ship financiers under the various legal systems worldwide are the ship mortgage which has primarily been developed by the courts under the common law tradition<sup>101</sup> and the civil law ship hypothecation which has been introduced by legislation.<sup>102</sup> Concerning the objective of entitling the secured creditor to preferential satisfaction of its claims through enforcement against the vessel, these rights can be regarded as being functional equivalents. But this diversity of the types of security interests that is due to legal history<sup>103</sup> still results in the availability of different remedies for the secured creditor in various jurisdictions.

The holder of a ship mortgage under common law legal systems traditionally has a stronger position in relation to the enforcement of its rights. Upon default, the mortgagee can exercise a right to possession of the ship, exercise control over the ship and enjoy its earnings (while also being liable for

<sup>97</sup> See, e.g., New Zealand: Ship Registration Act 1992, sec 23 (e)(xi); US-American UCC, sec 9-311 (a), exempting all assets whose encumbrances are subject to registration in an asset-specific register from registration requirements in the general debtor-indexed register. Moreover, sec 9-109 (c)(1) prevents the application of Article 9 to the extent that it is preempted by a federal statute such as the US-American Commercial Instruments and Maritime Liens Act 1988 (46 USC Chapter 313).

<sup>98</sup> See UNCITRAL Legislative Guide on Secured Transactions (2007), recommendation 77 and Chapter III, para 73 (p 121): while effectiveness against third parties in general can be achieved by registration in either the general register or in the asset-specific register, the priority status vis-à-vis competing secured creditors is to be determined on the basis of the registration in the asset-specific register; Drobnič and Böger (n 68) 453.

<sup>99</sup> See the situation in England: Beale, Bridge, Gullifer and Lomnicka (n 82) paras 14.41/45; Wood (n 47) para 28-030.

<sup>100</sup> In Australia, the Personal Property Securities Act 2009 has replaced the former provisions on the registered ship mortgage in the Shipping Registration Act 1981.

<sup>101</sup> See William Tetley, 'Maritime Transportation' in René David *et al.* (eds), *International Encyclopedia of Comparative Law*, Vol XII, ch 4 (Mohr 1997), para 320.

<sup>102</sup> Tetley (n 101) para 319; See generally Francesco Berlingieri, 'Lien holders and mortgagees: who should prevail?' [1988] *Lloyd's Maritime and Commercial Law Quarterly* 157, 162; John Kriz, *Ship Mortgages, 'Maritime Liens and their Enforcement'* [1963] *Duke Law Journal* 671, 677.

<sup>103</sup> For a more detailed description see: Böger (n 6) 29.

expenses)<sup>104</sup> and satisfy the secured claim out of the proceeds of an out-of-court sale of the ship.<sup>105</sup>

The holder of a ship hypothecation under a civil law system, on the other hand, can traditionally exercise its rights only through judicial enforcement, typically by way of a judicial sale.<sup>106</sup> To some extent, however, these differences can be overcome by parties contractually providing for a power of sale for the creditor, which has been reported as being a common market practice.<sup>107</sup> Moreover, in several civil law systems specific legislation has been enacted in order to grant the holder of a ship hypothecation such rights as are available to the mortgagee of a ship.<sup>108</sup>

### ***Issues regarding conflicts with non-consensual maritime liens***

Apart from the legal risks arising in relation to the publicity, recognition, priority and enforcement of consensual maritime proprietary security rights in a cross-border context, ship financiers face additional risks in relation to competing non-consensual proprietary security rights over ships, i.e. maritime liens. In certain situations, such maritime liens can take precedence even over earlier consensual maritime proprietary security rights, thereby

<sup>104</sup> See for English law: Beale, Bridge, Gullifer and Lomnicka (n 82) 18.37.

<sup>105</sup> See, e.g., the Australia: Personal Property Securities Act 2009, sec 128 (2) (the same remedy was available under the former Shipping Registration Act 1981, sec 41).

<sup>106</sup> See, for Argentina the references in Lennart Hagberg (ed), *Handbook on Maritime Law, Vol. III* (Kluwer 1983) 10; Germany: *Schiffsregistergesetz* (Ship Register Act), § 47; see generally on this distinction Giorgio Filippi, 'I diritti reali di garanzia sulla nave nell'ambito del diritto materiale uniforme' (2010) 112 *Diritto Marittimo* (Scritti in Onore di Francesco Berlingieri) 485, 510; Alexandra Mandaraka-Sheppard, *Modern Maritime Law* Volume 1, (Informa 2013) 178.

<sup>107</sup> Filippi (n 106) 512

<sup>108</sup> See, for instance, the preferred consensual security over ships under Greek Legal Decree 3899 of 1958; Sotiropoulos (n 6) 307.

effectively depriving the holder of the latter of its protection in the insolvency of the debtor. The laws of the different shipping jurisdictions as regards the scope and priority status of maritime liens differ widely and efforts for legal harmonisation have been largely futile so far. This makes things even worse for the holders of consensual security rights over ships. Whether and to what extent in a potential dispute their security rights might be held by a competent court to be negatively affected by maritime liens often depends upon the place where the ship is located at that particular moment or upon the choice of forum by the claimant (for which the location of the ship will also be a deciding factor), i.e. factors that are to some extent subject to chance and cannot be predicted in advance.

### ***Maritime liens in general***

A maritime lien is a proprietary security interest encumbering a ship that entitles the holder of the lien as a secured creditor to preferential satisfaction of its secured claims through enforcement against the ship.<sup>109</sup> As a true property right that also may be enforced against subsequent owners of the ship, the maritime lien should be distinguished from a merely procedural remedy in the form of a statutory right of action in rem,<sup>110</sup> which under the British and some Commonwealth national legal systems gives the beneficiary the right to arrest a ship as security for the satisfaction of certain maritime claims against the shipowner,<sup>111</sup> but which generally ranks below any other proprietary interest in the ship.<sup>112</sup>

Maritime liens are different from consensual maritime proprietary security rights such as the

<sup>109</sup> Tetley (n 101) 313; Ivon d'Almeida Pires Filho, 'Comparative Maritime Liens' (1984) 9 *Maritime Lawyer* 245.

<sup>110</sup> Tetley (n 73) 1910 s; Tetley (n 101) para 314.

<sup>111</sup> Tetley (n 101) para 314

<sup>112</sup> Tetley (n 73) 1911.

ship mortgage or hypothecation in that they arise by operation of law without the need for the conclusion of a security agreement between the parties to this effect.<sup>113</sup> This includes that the general publicity requirements for consensual proprietary security over movables do not apply,<sup>114</sup> i.e. there is no registration requirement and silent security interests are effective against other creditors including the holders of competing ship mortgages or hypothecs.

Instead, maritime liens automatically arise whenever there is a claim that is covered by the list of qualifying maritime claims in the relevant jurisdiction. There are, however, considerable differences as between the various legal systems concerning these lists of qualifying maritime claims that give rise to a maritime lien.<sup>115</sup> As regards situations such as claims for wages, there is widespread agreement that such claims deserve to be secured through an *ex lege* security right.<sup>116</sup> In other cases, however, there is no such unanimity, a main area of dispute being claims for necessities, i.e., bunkers, supplies, repairs, and towage, as

well as claims for cargo damage and general average.<sup>117</sup>

### *Priority status of maritime liens*

Maritime liens are subject to specific rules on priority that differ from the typical rules on the order of priority that apply to proprietary security rights in general, including ship mortgages and hypothecs. The general rule on the order of priority of competing proprietary security rights that appears to be universally accepted is that the first in time prevails, regardless of the types of proprietary interests involved.<sup>118</sup> The priority status of maritime liens, however, varies considerably between the various national legal systems.

Primarily, the ranking of maritime liens depends upon the type of maritime claim secured by the lien, i.e. maritime liens securing certain types of claims taking precedence over other maritime liens under national law (with differing orders of precedence in the different jurisdictions).<sup>119</sup> Moreover, even maritime liens for claims of the same type typically do not rank according to the order of creation. Instead, they are either regarded as all having the same priority position, regardless of which lien arose first,<sup>120</sup> or there may even a reversal of the usual order of priority, i.e. subsequent maritime liens take priority over maritime

<sup>113</sup> See Germany: *Handelsgesetzbuch* (Commercial Code), sec 597; Greece: Sotiropoulos (n 6) 299; United States: *Cardinal Shipping Corp v M/S Seisho Maru*, 744 F.2d 461, 466 (United States Court of Appeals, Fifth Circuit, 1984); see also Tetley (n 57) 5.

<sup>114</sup> Tetley (n 73) 1909 s.

<sup>115</sup> For English law see the list of maritime liens referred to in *The Ripon City* [1897] P. 226, 241 s.; *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221, at 232 (PC); France: *Code des transports* (Transport Code), art L5114-8; Germany: *Handelsgesetzbuch* (Commercial Code), §§ 596 s; Greece: Code of Private Maritime Law of 1958, art 205; Sotiropoulos (n 6) 307; United States: 46 USC, sec 31301(4) and (5), see Delos Flint, 'Current Developments in United States Maritime Lien Law' (1996) 8 University of San Francisco Maritime Law Journal 267, 269. For an overview over the law of maritime liens in Latin America see Pires Filho (n 109) 245.

<sup>116</sup> For England, see *The Ripon City* [1897] P. 226, 242; Germany: *Handelsgesetzbuch* (Commercial Code), § 596; Italy: *Codice della Navigazione* (Maritime Act), art 563; United States: 46 USC secs 31301(5)(D), 31342(a)(1).

<sup>117</sup> Such claims are secured by maritime liens, for instance, in the United States, see 46 USC, secs 31301 (4) and (5)(B), 31342(a)(1), and France, see *Code des transports*, art L5114-8, whereas under English law, there is no such protection for these types of claim, see the restricted list in *The Ripon City* [1897] P 226, at 242; Beale, Bridge, Gullifer and Lomnicka (n 82) para 6.166. For a comparison of various legal systems in this respect see Berlingieri (n 102) 158; Tetley (n 101), paras 313 ss.

<sup>118</sup> Cf the endorsement of this principle in the UNCITRAL Legislative Guide on Secured Transactions (2007), recommendation 76(a) and Chapter V, para 46 (p 196 s); Drobnig and Böger (n 68) 556.

<sup>119</sup> See Germany: *Handelsgesetzbuch* (Commercial Code), § 603(1); Italy: *Codice della Navigazione* (Maritime Act), art 563(1).

<sup>120</sup> See, for example, Germany: *Handelsgesetzbuch* (Commercial Code), § 604(1).

liens for earlier claims.<sup>121</sup> While this might at first appear surprising from the point of view of secured transactions law in general, such a preferred priority position of the latest maritime liens can at least as regards certain maritime claims for remuneration for services performed for the benefit of the ship in principle be based upon the reasoning that it is, for example, the last provider of repairs or supplies who keeps the ship on its venture and thereby allows it to earn freight, which is in the interests of all creditors.<sup>122</sup>

These specific priority rules for maritime liens also affect the priority position of holders of consensual maritime proprietary security rights such as ship mortgages or hypothecs. These security rights also have to give precedence to all<sup>123</sup> or at least some<sup>124</sup> types of

maritime liens recognised under the relevant national law, even if these liens are not registered and therefore not visible on any register or if they arise only after the creation of the ship mortgage or hypothecation. Effectively, a maritime lien that takes precedence over a ship mortgage or hypothecation may entirely deprive the holder of the latter of its security, especially in situations where the maritime claim underlying the maritime lien is for a substantial amount of money and does not necessarily correspond to the provision of services that benefit the value of the ship, e.g. in cases of maritime claims for damages. The extent to which the holder of a ship mortgage or hypothecation faces the risk of being negatively affected by higher-ranking maritime liens depends upon both the scope of the list of maritime liens under the relevant national law and this law's rules on the priority status of those maritime liens. These rules reflect general policy decisions of the legal systems concerned, favouring either the ship financing business (by protecting the priority status of ship mortgages or hypothecs) or the maritime service industry (by extending the scope of maritime liens) and these issues have proved to be highly contentious in past attempts to harmonise the law of proprietary security interests over ships that covered maritime liens as well.<sup>125</sup>

<sup>121</sup> See, for instance, for English law: Tetley (n 101) para 335; for United States law *The John G. Stevens*, 170 US 113, 119 (Supreme Court, 1898); under German and Italian law, this reversal of the usual order of priorities applies as provided for under the German *Handelsgesetzbuch* (Commercial Code), §§ 596 s, 604(3) and the Italian *Codice della Navigazione* (Maritime Act), art 563 (2), respectively. This principle has also been acknowledged by the international conventions in this field of law, which will be dealt with in more detail below 'Existing international instruments on proprietary security over ships and their lack of success', see the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, art 6 sent 2, the 1967 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, art 5(4), and the 1993 Geneva Convention on Maritime Liens and Mortgages, art 5(4).

<sup>122</sup> Richard Gyory, 'Security at Sea: A Review of the Preferred Ship Mortgage' (1962) 31 *Fordham Law Review*, 231, 258; Tetley (n 101) paras 333.

<sup>123</sup> See, for example, Germany: *Handelsgesetzbuch* (Commercial Code), § 603; China: all maritime liens have priority over ship mortgages, Article 25 of the Chinese Maritime Code of 1993, see Herbert Lord, 'The new Chinese Maritime Code' [1997] *International Business Law Journal* 924, including earlier mortgages, see Donglai Yang, 'A Comparative Analysis of Maritime Lien Priority under United States and Chinese Maritime Law' (1999) 23 *Tulane Law Journal* 465, 468.

<sup>124</sup> Argentina: *Ley no. 20.094/1974 Régimen de navegación* (Shipping Act), art 476; France: all privileged maritime liens enjoy priority over consensual

proprietary security rights in the ship, see *Code des transports* art. L5114-13, whereas privileges under the general law rank behind all ship mortgages, see art L5114-14. For a comparative summary of United Kingdom and the United States law see William Tetley, 'Maritime Liens in the Conflict of Laws' in James Nafziger and Symeon Symeonides (eds.), *Law and Justice in a Multistate World: Essays in Honor of Arthur T. von Mehren* (Ardsley 2002) 439-457.

<sup>125</sup> Alcántara (n 6) 232; Francesco Berlingieri, 'The 1993 Convention on Maritime Liens and Mortgages' [1995] *Lloyd's Maritime and Commercial Law Quarterly* 57; Lord Diplock in *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221, at 232 (PC); see also the repeated attempts to achieve international harmonisation through amendments and revisions of the catalogue of maritime liens and their priority under the various international instruments in this field, see below 'Existing international



*Conflict-of-laws rules regarding maritime liens*

The legal risks faced by holders of ship mortgages or hypothecations as regards competing maritime liens are further exacerbated by the fact that the determination of the applicable law governing maritime liens and their priority status adds additional uncertainties to this issue. Also the conflict-of-laws rules applied under the various legal systems worldwide vary significantly in this regard and there are at least three main approaches concerning the governing law for maritime liens and their priority status.<sup>126</sup> First, a general reference of the law of forum State, based upon the idea that maritime liens are argued to be primarily of a procedural character;<sup>127</sup> second, the application of the *lex causae* of the maritime claim underlying the maritime lien, i.e. the law that is applicable to the claim that is secured by this non-possessory security, for the issue of the existence of the maritime lien,<sup>128</sup> coupled with an application of the law of the forum as regards the determination of the priority status of the maritime liens amongst competing security interests (in order to avoid problems that would otherwise arise where there are several maritime liens arising under different governing laws);<sup>129</sup> third, the application of the law of the flag as to maritime liens,<sup>130</sup> even though

instruments on proprietary security over ships and their lack of success' below.

<sup>126</sup> For a more detailed description see Malcolm Clarke, 'Transport by Sea and Inland Waterways' in René David *et al.* (eds), *International Encyclopedia of Comparative Law*, Vol III, ch 26 (Mohr 1994), paras 62 ss.

<sup>127</sup> See, e.g., Australia: *Morlines Maritime Agency Ltd v the Proceeds of Sale of the Ship Skulptor Vuchetich* [1997] FCA 1627; China: Maritime Code of 1993, art. 272; England: *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221 (PC); *Oceanconnect UK Ltd v Angara Maritime Ltd* [2010] EWCA Civ 1050, at para 39 (CA); France: *Bonassies and Scapel* (n 79) 406.

<sup>128</sup> See, for instance, Canada: *Todd Shipyards Corp v Altama Compania Maritima SA (The Ioannis Daskalelis)* [1974] SCR 1248; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), art 45(2) sent 1; United States: *Dresdner Bank AG v MV Olympia Voyager* 463 F3d 1210 (11th Cir 2006).

especially in cases of the use of flags of convenience there will often be no substantial connection between the law of the flag and the circumstances that give rise to a claim secured by a maritime lien.<sup>131</sup>

### Existing international instruments on proprietary security over ships and their lack of success

There have been repeated attempts to solve the problems encountered in relation to the divergent national legal regimes on proprietary security over ships through the preparation and adoption of international instruments on these issues. The first to be mentioned here is the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages that was prepared by the Comité Maritime International. This Convention was later meant to be replaced by the Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages of 1967 which, however, never entered into force. The most recent harmonisation effort in this regard was undertaken with the Geneva Convention on Maritime Liens and Mortgages of 1993 that was supported by the International Maritime Organisation and the United Nations Conference on Trade and Development. As has been pointed out above, the fact that this instrument had been adopted only shortly before the Cape Town Convention was a major factor influencing the decision no longer to include ships in the early drafting stages of the Cape Town Convention in the mid-1990s.

<sup>129</sup> See, for instance, Canada: *Todd Shipyards Corp v Altama Compania Maritima SA (The Ioannis Daskalelis)* [1974] SCR 1248; United States: *The Scotia*, 35 F. 907, 911 (S.D.N.Y. 1888); Martin Davies, 'Choice of Law and US Maritime Liens' (2009) 83 *Tulane Law Review* 1435, 1457; Tetley (n 57) 15.

<sup>130</sup> Vrelis (n 87) 18; Italy: *Codice della Navigazione* (Maritime Act), art 6; Guido Ferrarini, 'Foreign law mortgages, hypothecues and charges in Italy' (1999) 6 *Journal of International Banking* 191, 194.

<sup>131</sup> Tetley (n 124) 455; Tetley (n 57) 45.



All these three international instruments on proprietary security over ships follow an approach that is markedly different from the Cape Town Convention system in a number of respects. As regards the issue of consensual proprietary security interests in ships in a cross-border context, unlike the Cape Town Convention the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention do not provide for the creation of an international interest. Instead, they follow a conflicts-of-laws approach concerning the recognition of foreign ship mortgages and hypothecs, providing that mortgages and hypothecations must be recognised if they are effected and registered in accordance with the requirements of the law of the flag.<sup>132</sup> The procedures and requirements for the registration of ship mortgages and hypothecations are not harmonised and are generally left to the law of the flag State instead.<sup>133</sup>

There is also no uniform regime for the enforcement or priority status of consensual security rights under the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention and also here these Conventions follow a conflicts-of-laws approach instead. Enforcement is generally regarded as an issue to be decided to the law of the forum,<sup>134</sup> while the priority status of consensual security rights is another issue that is referred to the law of the flag.<sup>135</sup>

Finally, the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention do not only address the issue of consensual proprietary security rights, but did also attempt to achieve a common position as regards non-consensual proprietary security rights over ships, i.e., maritime liens. Each of these Conventions contains a list of recognised maritime liens<sup>136</sup> and provides both for their priority status *inter se*<sup>137</sup> as well as for the general preference of these liens over consensual security rights such as ship mortgages and hypothecations.<sup>138</sup> The main differences between the three Conventions in this respect concern the scope of maritime liens.<sup>139</sup> While the 1926 Brussels Convention provided that claims for expenses incurred for the preservation of the vessel should be secured by a maritime lien,<sup>140</sup> this item is no longer included in the list of maritime liens in the 1967 Brussels Convention and the 1993 Geneva Convention. The 1967 Brussels Convention introduced an option for the Contracting States to provide for a maritime lien for claims for repairs of a ship, which could be given priority over registered proprietary security rights, but which would be extinguished once the repairer was no longer in possession of the ship.<sup>141</sup> Under the 1993 Geneva Convention, however, the priority of such maritime liens for repair claims under national law was downgraded and they do no longer rank before registered consensual security

<sup>132</sup> Brussels Convention 1926, art 1; Brussels Convention 1967, art 1(a); Geneva Convention 1993, art 1(a).

<sup>133</sup> The only exception being the – slightly differing – requirements in art 1(c) of the 1967 Brussels Convention and the 1993 Geneva Convention concerning the naming of the secured creditor in the register or in documents deposited with the register (unless the security is to bearer) and concerning the specification of the amount to be secured or maximum amount of the security.

<sup>134</sup> See art 16 of the 1926 Brussels Convention; art 2, last half-sentence of the 1967 Brussels Convention and of the 1993 Geneva Convention.

<sup>135</sup> See art 2 of the 1967 Brussels Convention and of the 1993 Geneva Convention. The 1926 Brussels

Convention did not regulate the priority status of consensual proprietary security rights *inter se*.

<sup>136</sup> See art 2 of the 1926 Brussels Convention; art 4 (1) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

<sup>137</sup> See arts 5 and 6 of the 1926 Brussels Convention; art 5(2)–(4) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

<sup>138</sup> See art 3 of the 1926 Brussels Convention; art 5 (1) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

<sup>139</sup> For a more detailed description of these differences between the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention, see Berlingieri (n 125) 62 ss; Alcántara (n 6) 223 ss.

<sup>140</sup> Art 2(1).

<sup>141</sup> Art 6(2).

interests.<sup>142</sup> Moreover, the 1993 Geneva Convention provided for the downgrading of maritime liens for port dues and similar claims vis-à-vis other maritime liens<sup>143</sup> and for the exclusion of maritime liens for oil pollution damage.<sup>144</sup>

While the 1926 Brussels Convention attracted 28 States Parties in total, it generally failed to gain support among the most important shipping nations worldwide.<sup>145</sup> The 1967 Brussels Convention was ratified by only three States<sup>146</sup> and never entered into force since it did not meet the required number of five States Parties.<sup>147</sup> The drafting and adoption of the 1993 Geneva Convention was motivated by what was widely regarded as a failure by the 1926 and 1967 Brussels Conventions to attract widespread support,<sup>148</sup> but in the end the 1993 Geneva Convention was even less successful with only 18 States Parties.<sup>149</sup>

Arguably the most decisive factor for the lack of success of these three Conventions was the fact that it proved to be impossible to reach a satisfactory compromise position on the issues of maritime liens, their scope and their priority status vis-à-vis consensual ship mortgages and hypothecations. The dilemma that there is a strong divergence of interests between States where the focus of the economic activity as regards shipping is the financing the construction and purchase of ships (which argues in favour of giving precedence to the interests of mortgage creditors) and States whose maritime industry focusses on the maritime service industry (which argues in favour of protecting a broad class of maritime lienholders)<sup>150</sup> has not been solved by the 1993 Geneva Convention, as is confirmed by the low number of Contracting States which the Convention has been able to attract in the 20 years since its promulgation.<sup>151</sup>

<sup>142</sup> Art 6(c), for the right of retention in such situations see art 7.

<sup>143</sup> Art 4(1)(d).

<sup>144</sup> Art 4(2).

<sup>145</sup> The following States are Parties to the 1926 Brussels Convention: Algeria, Argentina, Belgium, Brazil, Cuba, Denmark, Estonia, Finland, France, Haiti, Hungary, Iran, Italy, Lebanon, Luxembourg, Madagascar, Monaco, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Syria, Turkey, Uruguay, Zaire. Denmark, Finland, Norway and Sweden have declared their denunciation of the 1926 Convention. Source: <<http://www.comitemaritime.org/Uploads/pdf/CMI-SRMC.pdf>> accessed 21 September 2016.

<sup>146</sup> Denmark, Norway and Sweden, see <<http://www.comitemaritime.org/Uploads/pdf/CMI-SRMC.pdf>> accessed 21 September 2016.

<sup>147</sup> Art 19(1).

<sup>148</sup> Lief Bleyen, *Judicial Sale of Ships: A Comparative Study* (Springer 2015) 12.

<sup>149</sup> The following States are Parties to the 1993 Geneva Convention: Albania, Benin, Congo, Ecuador, Estonia, Lithuania, Monaco, Nigeria, Peru, Russian Federation, Serbia, Spain, St. Kitts and Nevis, St. Vincent and the Grenadines, Syria, Tunisia, Ukraine, Vanuatu. See <[https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&cmdsg\\_no=XI-D-4&chapter=11&clang=\\_en](https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&cmdsg_no=XI-D-4&chapter=11&clang=_en)> accessed 21 September 2016.

### **How the extension of the Cape Town Convention system to ships would solve current issues concerning proprietary security over ships in a cross-border context**

In the previous sections, it has been shown that the current issues concerning proprietary security over ships in a cross-border context have not been satisfactorily addressed by the existing international instruments in this field of law. This article, however, argues that there is a case for the extension of the Cape Town Convention system to ships. This section will describe how the application of the Cape Town Convention system to ships would solve the main problems concerning proprietary security over ships in a cross-border context and what advantages the approach of

<sup>150</sup> See 'Priority status of maritime liens' above.

<sup>151</sup> See also the critical evaluation: Alcántara (n 6) 231 ss; Alexandra Mandaraka-Sheppard, *Modern Maritime Law and Risk Management*, (2nd edn Informa 2009) 381; Mark Yost, 'International Maritime Law & the US Admiralty Lawyer' (1995) 7 University of San Francisco Maritime Law 313, 342.

the Cape Town Convention has in these respects as compared to alternative solutions.

***Validity and effectiveness of security rights over ships under a foreign flag***

As has been described above, a major concern for secured creditors as regards the use of proprietary security rights over ships in a cross-border context is that, should the ship become subject to proceedings brought by a competing creditor in a foreign jurisdiction into which the ship may have sailed in the course of its operation, the courts of the forum State might not recognise the validity of the secured creditor's registered ship mortgage or hypothecation by reason of the fact that this security right is registered under a foreign law of the flag.<sup>152</sup> The application of the Cape Town Convention system to ships would protect secured creditors against this risk and an international interest under the Convention that is duly registered would be effective in any Contracting State, regardless of the forum or the flag State. Since all Contracting States and their courts would be bound by the terms of the Convention to give effect to the international interests, there would not be a risk that the validity and effectiveness of security rights other than those registered in the domestic register could be denied. This is a marked advantage as compared to a mere (autonomous) adherence of a national legal system to the principle of the law of the flag which, as experience shows, can sometimes be reversed by domestic courts.

***Advantages of the registration in a single international register for international interests in ships***

One of the most characteristic features of the Cape Town Convention system is that it provides for a registered international interest and a single international register.<sup>153</sup> A requirement

<sup>152</sup> See 'Maritime liens in general' above.

<sup>153</sup> Art. 16; see 'Outline of the secured transactions regime of the Cape Town Convention and its possible extension to ships' above. The Convention allows,

of publicity by registration is already a common feature for ship mortgages and hypothecations in general.<sup>154</sup> However, on the basis of the extension of the Cape Town Convention system to ships, the registration of ship mortgages and hypothecations in numerous different national registers would be replaced by the registration of the international interest in a single international register.

This would be greatly beneficial to the process of obtaining proprietary security over ships in a cross-border context. Secured creditors wishing to take security over a vessel under a foreign flag would no longer face the additional cost and effort of ascertaining and complying with procedural requirements for the registration of ship mortgages or hypothecations under a foreign law, depending on the relevant State of registration. This is an important advantage of the Cape Town Convention system's uniform law approach as compared to the conflicts-of-laws approach of the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention.<sup>155</sup> Under the conflicts-of-laws approach, secured creditors may rely on application of the law of the flag, but the fact that the substantive content of the applicable rules concerning law will vary as between the legal systems of the various flag States creates additional burdens and legal risks for secured creditors and

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however, the use of national entry points for the international register (see Art 18(5) of the Convention and Art. XIX of the Aircraft Protocol) which allows Contracting States to designate entry points under national law, through which there shall or may be transmitted to the International Registry information required for the registration of international interests. This allows, e.g., the continued operation of registers for proprietary security under national law which would then be used as an entry point for transmission of information to the international register.

<sup>154</sup> See 'Registration of ship mortgages and hypothecations in ship registers under national law' above.

<sup>155</sup> See 'Existing international instruments on proprietary security over ships and their lack of success' above.

thereby increases the cost and reduces the availability of finance.<sup>156</sup>

The application of the Cape Town Convention system to ships would also solve the issue that there is no unanimity at the moment as regards the relationship between the registration of security interests over ships in asset-specific ship registers and general debtor-indexed registers under national law.<sup>157</sup> In cross-border transactions in particular, such double registration requirements might constitute an obstacle to the effectiveness of consensual security over ships. Under the Cape Town Convention system, however, the creation, priority status and insolvency effectiveness of registered international interests that fulfil the Convention requirements<sup>158</sup> is governed by international law. These provisions of an international instrument cannot be made subject to the fulfilment of requirements of national law merely by reason of the existence of a requirement under national law to register all security rights in a general debtor-indexed register. Therefore, there could no longer be a need for a parallel registration of security over ships in a national debtor-indexed register.<sup>159</sup>

A single International Register set up under the Cape Town Convention system would also make searches for existing security interests easier. All searches could be directed to the same International Register instead of different national registers; moreover, the International Register operates electronically and allows direct, around-the-clock access for search purposes to anyone interested in its content.<sup>160</sup> By improving access to the register, the

publicity function of registered security interests is greatly enhanced compared to that of registers operated by traditional methods and on a purely national level. To some degree, such enhanced publicity could also be achieved by improving the *modus operandi* of national registration systems. However, a unified register can only be achieved on the basis of an international instrument and the extension of the Cape Town Convention system to ships has the further advantage that the registration system under the Cape Town Convention has already been tested in practice, which serves as additional proof that existing misgivings about the electronic operation of registers of proprietary security are unjustified.

A unified register for international interests would also be of great advantage in situations of a demise charter where the vessel may under the laws of some jurisdictions be temporarily registered in a secondary register under another flag chosen by the charterer. Interests registered in the original register would not be visible to third parties through a search of the secondary register.<sup>161</sup> Some registers allow the secured creditors to enter a notice into the secondary register referring to a registered interest in the original register;<sup>162</sup> another possibility is to provide that on the ship itself there must be a notice referring to the existence of a ship mortgage registered in the original register.<sup>163</sup> Given the operation of a unified register under the Cape Town Convention system, such difficulties could be avoided since all international interests would be registered in the unified international register.

In any case, national shipping registers would not be set aside by the introduction of an additional Protocol to the Cape Town Convention. The international registers under the Cape Town Convention system only deal

<sup>156</sup> Goode (n 1) 95.

<sup>157</sup> See 'Security over ships and registration in general debtor-indexed registers' above.

<sup>158</sup> Arts 7, 29 and 30.

<sup>159</sup> However, parties would not be prevented from continuing to register security over ships in the debtor-indexed register as well, should they wish to do so, for instance as a measure of caution in case of doubt.

<sup>160</sup> See art 22, see also the Regulations for the International Registry under the Cape Town Convention, regs 3.4 and 7.

<sup>161</sup> Lucy French, 'Introduction' in Stephenson Harwood (ed), *Shipping Finance* (3rd edn. Euromoney Books 2006) 10.

<sup>162</sup> French (n 161) 10.

<sup>163</sup> See for English law: Graeme Bowtle and David Osborne, *The Law of Ship Mortgages* (CRC Press 2015) 22.

with the issues covered by the Convention and its Protocols (i.e. international interests and, in the case of the Aircraft Protocol<sup>164</sup> and the Luxembourg Rail Protocol,<sup>165</sup> sales or, respectively, notices of sale), while the determination of a law of registration under a national flag would still be relevant for, amongst others, labour and safety regulations<sup>166</sup> or the effects of registration on issues of ownership which, however, vary according to the applicable national law.<sup>167</sup>

### *A clear and uniform system of priority for consensual proprietary security over ships*

The Cape Town Convention contains a uniform regime of priority as between the proprietary security interests covered by the Convention, their priority status being primarily determined by registration in the international register.<sup>168</sup> The application of these uniform priority rules would provide for increased predictability for market participants concerning the status of their consensual proprietary security interest vis-à-vis competing interests. Parties would no longer face the risks arising from the fact that the priority status of their proprietary security rights would follow different rules under the various national legal systems.<sup>169</sup> Again, this is in marked contrast with the approach of the 1967 and 1993 Conventions on Maritime Liens and Mortgages, which do not harmonise the rules on priority as

between consensual security rights over ships and refer to the law of the flag instead.<sup>170</sup>

### *Harmonisation of the remedies on default*

Another area of law where the adoption of an additional Protocol to the Cape Town Convention has the potential of furthering the modernisation of law is the issue of remedies on default. As referred to above,<sup>171</sup> a distinction is traditionally made between the remedies available under a mortgage over a ship, on the one hand, and under the hypothecation of a ship, on the other hand. Such distinctions are difficult to justify from the point of view of a modern functional approach to proprietary security. They add additional complications to the position of secured creditors holding numerous security rights over ships sailing under different flags.

The Cape Town Convention for its part makes no distinction between the remedies available to a secured creditor holding an international interest (other than that of a retention of title seller or lessor).<sup>172</sup> The position of the secured creditor is improved by a strong emphasis on self-help remedies and by the possibility of appropriation of the encumbered asset in satisfaction of the secured claim. Still, the Convention generally acknowledges the principle of party autonomy as to the choice of available remedies<sup>173</sup> and also provides that remedies generally are to be exercised in conformity with the procedural provisions of the forum.<sup>174</sup>

<sup>164</sup> Aircraft Protocol, art III.

<sup>165</sup> Luxembourg Rail Protocol, art XVII.

<sup>166</sup> As regards aircrafts, the Dublin International Register under the Cape Town Convention system, with its registration of international interests in aircraft, exists alongside national registers in which the aircraft themselves continue to be registered for purposes of determination of nationality.

<sup>167</sup> See, for example, Hagberg (n 106), 3 (for Argentina), 141 (for England), 169 (for Germany), 215 (for Greece), 314 (for Liberia), 330 (for Malta).

<sup>168</sup> Art 29; see 'Outline of the secured transactions regime of the Cape Town Convention and its possible extension to ships' above.

<sup>169</sup> See 'Priority of consensual proprietary security over ships' above.

<sup>170</sup> Goode (n 6) 163.

<sup>171</sup> See 'Different remedies under existing proprietary security rights' above.

<sup>172</sup> Art 8(1).

<sup>173</sup> To the extent that such agreements on the available remedies are permitted under the applicable law, see art 12 and Roy Goode, *Convention on International Interests in Mobile Equipment and Protocol thereto on Matters specific to Aircraft Equipment, Official Commentary* (3rd edn Unidroit Books 2013) para 4.108.

<sup>174</sup> Art 14. As regards the exercise of the secured creditor's rights under the specific insolvency Alternatives of the Protocols to the Cape Town Convention (see 'Outline of the secured transactions regime of the

***No attempt to harmonise the law of maritime liens in general***

The introduction of an additional Protocol to the Cape Town Convention covering ships would not lead to legal harmonisation as regards maritime liens. The Cape Town Convention primarily addresses only consensual proprietary security rights<sup>175</sup> and contains no harmonised rules on non-consensual security rights in general. This is a major point of distinction between the Cape Town Convention system and the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention. Those Conventions all included detailed harmonised rules on the creation and priority status of maritime liens, i.e. non-consensual proprietary security over ships.<sup>176</sup>

As indicated above,<sup>177</sup> the various national legal systems differ widely concerning the lists of recognised maritime liens, i.e., the situations which, under the various national regimes of maritime law, give rise to such maritime liens, the priority status of these non-consensual security rights and the relevant conflict-of-laws rules. It is therefore not surprising that this is an area of law where legal harmonisation was often thought to be most sorely needed, as evidenced by the repeated attempts to harmonise the law of maritime liens in the 1926 and 1967 Brussels Convention and in the 1993 Geneva Convention.

Still, the fact that an additional Protocol to the Cape Town Convention covering ships would not address these issues should not be regarded as an argument against such an extension of the Cape Town Convention system. It should be borne in mind that these divergences

between the various national legal systems as regards maritime liens and the fact that no broad international consensus has been achieved so far in this respect have so far proved an insuperable obstacle to the success of major harmonisation efforts in this field of law.<sup>178</sup> The limited scope which a new Protocol would have in this respect may be expected to raise its chances of finding broader support by leaving out issues where international consensus is unlikely to emerge. Whereas previous attempts at international harmonisation in the field of proprietary security over ships failed largely because it proved impossible to overcome the conflict between the competing interests of the relevant shipping nations that preferred different groups of creditors (creditors financing the construction and purchase of ships, on the one hand, and the shipping service, supply and repair industries, on the other hand), the suggested extension of the Cape Town Convention system to ships would affect the position of secured creditors holding consensual proprietary only, i.e. ship mortgages or hypothecations. Thus, the consensual proprietary security rights over ships could be strengthened and the (re-)financing of the worldwide merchant fleets could be supported without creating a corresponding disadvantage for the shipping service, supply and repair industries and the position of their maritime liens.

A similar policy of self-restriction has been followed under the recent Draft Convention for the Recognition of Judicial Sales of Ships prepared by the Comité Maritime International.<sup>179</sup> The judicial sale of ships, specifically as a type of enforcement of rights under proprietary security rights in ships, was also addressed by the 1967 Brussels Convention and 1993 Geneva Convention.<sup>180</sup> However,

Cape Town Convention and its possible extension to ships' above), the declaration of the Contracting State that is the primary insolvency jurisdiction is decisive, see art IX of the Aircraft Protocol, art IX of the Luxembourg Rail Protocol and art XXI of the Berlin Space Protocol.

<sup>175</sup> See the international interests covered by art 2.

<sup>176</sup> 'Existing international instruments on proprietary security over ships and their lack of success' above.

<sup>177</sup> See 'Issues regarding conflicts with non-consensual maritime liens' above.

<sup>178</sup> See the references in n 125.

<sup>179</sup> See the project webpage of the Comité: <[www.comitemaritime.org/Recognition-of-Foreign-Judicial-Sales-of-Ships/0,2750,15032,00.html](http://www.comitemaritime.org/Recognition-of-Foreign-Judicial-Sales-of-Ships/0,2750,15032,00.html)> accessed 21 September 2016.

<sup>180</sup> Brussels Convention 1967, art 11; Geneva Convention 1993, art 11.



it was argued that an additional instrument dealing with these issues would be opportune,<sup>181</sup> even at the risk of overlap with the existing Conventions on Maritime Liens and Mortgages. The limited success of the 1993 Geneva Convention and the scant likelihood of many further accessions argue in favour of a new international instrument that would avoid the internationally disputed issue of maritime liens which, as experience shows, has proved something of an obstacle to broad support, however welcome such broader solutions would be from the standpoint of international legal harmonisation and the efficiency of cross-border transactions. While not striving to achieve full legal harmonisation as regards non-consensual security rights, however, the Cape Town Convention system would at least improve legal certainty and clarity in this respect under the rules of Articles 39(1)(a) and 40 of the Cape Town Convention which provide for the deposition by the Contracting States of lists of categories of non-consensual rights that may, either generally or if registered earlier, enjoy priority over registered international interests under the Convention<sup>182</sup>: This ensures that secured creditors cannot be negatively affected by any possible non-consensual interest under national law, but only by those that are contained in these lists.<sup>183</sup>

### Some specific issues to be considered in the drafting process

In the drafting of a new Protocol to the Cape Town Convention covering ships, the peculiarities of the shipping finance business would have to be taken into consideration and any amendment to the general principles

<sup>181</sup> William Sharpe, 'Towards an International Instrument for Recognition of Judicial Sales of Ships – Policy Aspects' <[www.comitemaritime.org/Recognition-of-Foreign-Judicial-Sales-of-Ships/0,2750,15032,00.html](http://www.comitemaritime.org/Recognition-of-Foreign-Judicial-Sales-of-Ships/0,2750,15032,00.html)> accessed 21 September 2016.

<sup>182</sup> See below 'Non-consensual rights'.

<sup>183</sup> The declarations are available under <<http://www.unidroit.org/depositary-2001capetown?id=438>> accessed 21 September 2016.

of the Cape Town Convention that is deemed necessary could be agreed. It would certainly go too far to set out all the possible issues that could be taken into consideration in the drafting process, but some more relevant issues can be highlighted here.

### *Avoiding conflicts with other international instruments dealing with enforcement issues (arrest and judicial sales)*

A new Protocol to the Cape Town Convention should avoid conflicts with the Brussels Convention relating to the Arrest of Seagoing Ships of 1952 and the Geneva Convention on the Arrest of Ships of 1999. The same should apply in relation to the proposed Draft Convention for the Recognition of Judicial Sales of Ships. Generally, the Cape Town Convention provides that the exercise of any remedies under the Convention should follow the procedural rules of the law of the forum.<sup>184</sup> This general rule ensures that the provisions of the law of the forum take precedence over those of the Convention, including any rules provided by international instruments to which the forum State is a party. However, it would appear that alignment of the rules under the Cape Town Convention on the immobilisation of the object as a form of relief pending final determination<sup>185</sup> with the rules of the 1952 and 1999 Arrest Conventions could be considered.

### *Non-consensual security rights*

As discussed above, a Protocol on ships would differ from the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention in that it would not cover non-consensual security rights, i.e. maritime liens, in general, but only to the extent provided for in Articles 39(1)(a) and 40 of the Cape Town Convention.

However, caution would have to be applied even with regard to the application of those provisions in the Cape Town Convention that to a limited extent allow non-consensual proprietary

<sup>184</sup> Art 14.

<sup>185</sup> Art 13(c).

security to be brought within the scope of the Convention. First, Article 39(1)(a) allows each Contracting State to deposit with the Depositary a list of categories of non-consensual rights or interests that have priority over an interest equivalent to a registered international interest under the national law of the Contracting State and which are to have priority over registered international interests under the Convention.<sup>186</sup> In effect, this comes close to a rule under which the determination of the priority status of the non-consensual security is to be determined under the rules of the same law that governs its creation, i.e. the law of the Contracting State that has deposited the list which includes that security right or interest. While there are several legal systems that refer the issues of creation and priority of non-consensual security over ships to the same applicable law, other jurisdictions apply different conflict-of-laws rules to these matters.<sup>187</sup> Second, according to Article 40 each Contracting State may deposit with the Depositary a list of non-consensual security interests which will be registrable under the Convention as if they were registrable international interests and which will be regulated accordingly. This includes the determination of the priority status according to the order of registration.<sup>188</sup> While Article 40 does not go as far as Article 39 in conferring preferred priority status on the interests covered by this provision, it is to be noted that its effect is that

<sup>186</sup> In more detail, this provision operates as follows: it does not harmonise the conditions for the creation of the non-consensual rights or interests covered in the list deposited by the Contracting State; and such rights or interests will only arise if the conflict-of-law rules of the forum determine the law of the Contracting State concerned as the regime governing the issue of the creation of non-consensual security rights. Also, the Convention does not attempt to harmonise these conflict-of-laws rules. However, the priority status of this non-consensual security is determined on the basis of the provisions of the Convention but following the position of the Contracting State concerned as expressed in the declaration deposited with the Depositary.

<sup>187</sup> See 'Conflict-of-laws rules regarding maritime liens' above.

<sup>188</sup> See art 29.

an interest thus covered can no longer be treated as enjoying generally lower priority ranking than consensual proprietary security interests in the same asset, even if this would be the position if the conflict-of-laws provisions of the forum and the applicable legal regime for the determination of the priority status of this type of non-consensual security were applied. To solve this problem and in order to avoid venturing into the disputed areas of non-consensual security over ships, Articles 39 and 40 could be made subject to a rule in the additional Protocol on ships according to which the non-consensual interests covered in the declaration of the Contracting State concerned will enjoy such a privileged priority position only if, according to the conflict-of-laws rules of the forum, the issue of the priority status of non-consensual security interests is to be governed by the laws of the Contracting State concerned or under any other legal regime under which an equivalent priority position is awarded to these non-consensual security interests.

### ***Registrability of interests other than ship mortgages and hypothecations***

While the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention only cover ship mortgages and hypothecations, the Cape Town Convention system firmly acknowledges the use of retention of title and leasing as alternative agreements on which to base proprietary security.<sup>189</sup> This broad view of the various arrangements made by the parties that are to be covered by the secured transactions regime of the Cape Town Convention corresponds to the functional approach to the law of proprietary security in general which has become the dominant view worldwide.<sup>190</sup>

<sup>189</sup> See art 2(2). On this distinction and on the relevance of leasing and retention of ownership agreements concerning ships see also: Goode (n 6) 164.

<sup>190</sup> UNCITRAL Legislative Guide on Secured Transactions (2007) ch IX, para 67, p 335.

However, it is an issue that should be carefully considered especially in relation to retention of ownership agreements whether the application of this modern functional approach would be consistent with the current expectations in the market as regards the use of retention of ownership agreements over vessels. It is therefore much to be welcomed that the current fact-finding work of the Comité Maritime International's Working Group on Ship Financing Security Practices devotes much attention to the use of retention of ownership agreements over ships.<sup>191</sup> It is submitted that if the new Protocol would cover such agreements, this would be of greatly beneficial effect for the use of retention of ownership agreements over ships in cross-border transactions. Retention of ownership agreements are typically not registrable in traditional registers of title and as unregistered interests, they are not likely to be recognised in a foreign forum.

### *Protection of the charterer*

In some legal systems, there are complex rules concerning the restriction of the exercise of the rights under a ship mortgage, especially concerning the mortgagee's right to take possession, where this would affect a charterer of the vessel.<sup>192</sup> Whether and under which conditions such a rule should be included in a Protocol covering security over ships is an issue that certainly deserves to be addressed in the drafting process of such a new Protocol. It should, however, be noted here that if the charterparty itself would be registrable under the new Protocol, the general priority rules of the Convention would be applicable to such a situation.

### *Registrability of interests in other assets in the marine sector*

Finally, the preparation of a new Protocol on ships would constitute an opportunity to

consider extending the scope of the Cape Town Convention system to other assets in the marine sector as well. Container fleets<sup>193</sup> and flettner rotors<sup>194</sup> are assets whose use as collateral has been suggested to be considered in this regard. Concerning the suitability of such additional maritime assets for inclusion into the scope of the new Protocol, a similar analysis should be employed as underlying the determination of the scope of the draft Protocol on Matters specific to Agricultural, Construction and Mining Equipment, i.e. the core question should be whether these are mobile assets of high value<sup>195</sup> that could be separately financed as a matter of market practice.<sup>196</sup>

## **Conclusions**

The law of proprietary security over ships is characterised by strong divergences between various legal systems and by a high degree of uncertainty for market participants, especially secured creditors, concerning the applicable law in the event of a dispute. This puts secured creditors at risk of losing their security position, especially through the non-recognition of their registered security over a vessel before the courts of a foreign forum State, by an inadvertent failure to comply with registration procedures under a foreign law of registration or the unanticipated application of rules on the order of priority under the law of the forum. Such risks, together

<sup>193</sup> Containers had originally been suggested for inclusion under the scope of the Cape Town Convention, see art 2(1)(e) of the first set of draft articles of a future UNIDROIT Convention on Interests in Mobile Equipment, March 1996, UNIDROIT document Study LXXII – Doc 24. See also the report prepared for the 2013 UNIDROIT Governing Council, UNIDROIT 2013 – C.D. (92) 5 (c)/(d), at para 76.

<sup>194</sup> <<http://www.mainportlawyers.com/content/new-protocols-cape-town-convention-update-unidroit-governing-council%E2%80%99s-meeting-2014>> accessed 21 September 2016.

<sup>195</sup> Cape Town Convention, art 51(1).

<sup>196</sup> See the report of the third Study Group meeting UNIDROIT 2015 – Study 72K – SG3 – Doc 5, para 42.

<sup>191</sup> See the questionnaire referred to in n 16.

<sup>192</sup> For English law see *The 'Myrto'* [1977] 2 Lloyds Rep 243; Bowtle and Osborne (n 163) 179.

with the additional efforts and costs of legal advice that become necessary for secured creditors when conducting secured transactions in such an environment will reduce the availability of financing and increase its costs, including the premiums for credit insurance. All this ultimately works to the detriment of the debtor seeking financing and in the current economic climate in the market for shipping finance no measure should be left unused that could improve the availability of credit and its conditions. The recent Brazilian Court of Appeals decision in the OSX-3 case is further proof that the current legal framework does not sufficiently protect the interests of secured creditors in cross-border disputes and action should be taken to remedy this situation.

The preparation of a new Protocol to the Cape Town Convention covering ships could be an enormously valuable contribution to the law of proprietary security over ships worldwide, most prominently:

- (1) by providing for a registered international interest under the provisions of the Cape Town Convention and the new Protocol thereto that is accepted throughout the Contracting States, thereby eliminating the risk that a court in a Contracting State could deny the validity and effectiveness of a consensual proprietary security right such as a ship mortgage or a hypothecation over a vessel sailing under a flag other than that of the forum State on the basis of the argument that the security is registered not in the register of the forum State, but under the law of the flag;
- (2) by harmonising the requirements and details of registration of consensual security rights over ships, thereby doing away with the widely divergent procedures for the perfection of ship mortgages and hypothecations currently required under various national laws;
- (3) by enhancing the publicity given to the registration of consensual security over

ships through the introduction of a unified, efficient system of registration operated electronically, the workability of which has already been proven in practice for security rights in aircraft;

- (4) by harmonising the rules on the priority status as between consensual security rights over ships, thereby enhancing certainty in commercial transactions since parties would no longer need to consider the risks attendant upon the fact that each national legal system has its own rules concerning the priority status of such rights; and
- (5) by providing for a harmonised set of remedies on default instead of the current distinction between the remedies available under common law mortgages and civil law hypothecations, thereby generally strengthening the position of the secured creditor by putting an emphasis on the availability of self-help remedies and on the possibility of taking possession and appropriating the collateral as a method for enforcement of the security, even in the event of the debtor's insolvency.

It has been argued that there is generally no need for an international instrument where an equivalent result could be achieved through a reform of national laws.<sup>197</sup> While it is true that some of the issues mentioned above could be dealt with at national level as well, especially the harmonisation of remedies, the creation of an international interest and the unification of the registration system for all Contracting Parties under the new Protocol would be an advantage that can only be achieved through a new international instrument.

Moreover, while it generally would be more preferable to seek to attract additional Contracting Parties for existing conventions than to prepare a new international instrument,<sup>198</sup>

<sup>197</sup> Gabriel (n 23) 75.

<sup>198</sup> Patrick Griggs, 'Uniformity of Maritime Law – An International Perspective' (1999) 73 *Tulane Law Review* 1551, 1569.

this reasoning should not argue against the preparation of a new Protocol on ships. The 1993 Geneva Convention is not likely to attract a significant number of additional Contracting Parties, especially among the important shipping nations, in addition to its present 18 Parties. A new Protocol on ships would have much better chances of obtaining broader support due to the fact that it would avoid the highly contentious issue of maritime liens.

Shipping finance is a market that has very peculiar characteristics, mainly the volatility of earnings in the shipping industry, its highly cyclical nature and the resulting risk of overcapacity, all of which affect freight rates, the demand for new shipbuilding and, indirectly, also the value of the ships liable to be used as collateral.<sup>199</sup> Nevertheless, while these factors often limit the application of a conventional credit analysis to ship financing, the cutting of transaction costs through the reduction of inefficiencies in the law remains an advantage in any financing environment. Strengthening the position of consensual proprietary security rights over ships, as would be the objective of a new Protocol on ships, would therefore be of huge significance for the financing and re-financing of the merchant shipping industry in the same way as it would be relevant for other industries.<sup>200</sup> To the extent that the legal environment of the present market for shipping finance has specific characteristics that should be taken into consideration in an international instrument on consensual

security rights over ships, these specific issues could be addressed in the potential Protocol on ships and the relevant shipping organisations would be able to contribute to the drafting process, which of course would to a great extent rely upon their specialist expertise. Concerning the question whether the secured transaction regime under the Cape Town Convention system as such could be regarded as being compatible with the national legal systems of potential Contracting States of such an additional Protocol in general, it is worth noting that already now five out of the ten countries with the largest merchant navy,<sup>201</sup> representing nearly 40 per cent of the total gross register tonnage of the world's merchant navies combined, are Contracting Parties to the Cape Town Convention and the Aircraft Protocol<sup>202</sup>. Thus, these major shipping nations have already shown themselves open to the application of the regime of the Cape Town Convention system in general.

In conclusion, there is a clear case for the preparation of a new Protocol to the Cape Town Convention covering security over ships. Should UNIDROIT and the Comité Maritime International continue their work on this project and should they succeed in advertising its advantages to interested industry circles, it is to be expected that the project could well attract the necessary support by governments, industry and interested circles to become another successful addition to the Cape Town Convention system.

<sup>199</sup> Alan Brauner and Peter Illingworth, 'The bankers' perspective' in Stephenson Harwood (eds), *Shipping Finance* (3rd edn Euromoney Institutional Investor 2006) 67, 71.

<sup>200</sup> Alcántara (n 6) 232; Goode (n 6) 165; Haight (n 6) 195; Sotiropoulos (n 6) 308.

<sup>201</sup> By reference to the gross register tonnage of vessels registered in the individual State's ship register.

<sup>202</sup> China, Malta, Panama, Singapore and the United Kingdom. See the statistical data set of the United Kingdom's government 'World fleet registered vessels (FLE05)' <<https://www.gov.uk/government/statistical-data-sets/fle05-world-fleet-registered-vessels>> accessed 21 September 2016.