

Ship Finance 2021

Contributing editor
Lawrence Rutkowski
Seward & Kissel LLP



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Lexology Getting The Deal Through is delighted to publish the eighth edition of *Ship Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China and Russia.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Lawrence Rutkowski of Seward & Kissel LLP, for his continued assistance with this volume.



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Introduction

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In previous editions of this volume, much of the discussion in this introduction was focused on the enormous changes taking place in the ship finance market. That makes sense, of course. After all, this is a volume about the laws of ship finance. What has driven these changes? Clearly, rapid changes in the global financial markets have had a significant impact on the shape of the industry, starting with the banking industry. The banking industry (among others) was severely buffeted by the winds of the financial crisis a bit more than a decade ago. The after currents of that crisis are still being felt. For example, one key issue affecting lending today is the transition away from LIBOR as the benchmark rate for pricing dollar-based loans in the international market. Indeed, one can say with a fair degree of certainty that, aside from the rare fixed rate loan, nearly all shipping loans were priced off of LIBOR. Now, LIBOR is soon to be a relic of the past, a casualty of the financial crisis. As of this writing, the most likely successor to LIBOR is SOFR (the Secured Overnight Financing Rate). Yet, universal agreement on SOFR as a benchmark rate has not yet been achieved. Add one more quandary for banks in the shipping industry.

As we have observed before, even the casual student of ship finance will be aware that for decades, the shipping industry's principal source of capital was the international bank market. The typical transaction involved a single bank making a loan to a single-purpose company, sometimes supported by a parent company or personal guarantees, but ultimately secured by a mortgage over the ship financed. The loan had a tenor of three to five years, amortisation was based on a profile tied to the vessel's useful life, and scrap value and interest was based on LIBOR. The vessel would be flagged (ie, registered) in one of a handful of select jurisdictions with which the banking industry had become comfortable. Now, the number of banks lending to the industry has declined dramatically and it is on pace to decline further. Even some shipping industry stalwarts are exiting ship finance markets. Many simply lost too much money as a direct consequence of client insolvencies during and following the financial crisis. Others have found returns on capital deployed to the industry constrained by new capital adequacy requirements intended to prevent future crises. Yet others are institutionally crippled by the demands of new regulations designed to prevent money laundering and sanctions violations. And, as noted above, banks and borrowers alike continue to struggle with the future post-LIBOR world of finance. Add to these troubles, the global pandemic and its effect on global supply chains, the magnitude of which is still unfolding. And it is impossible to ignore just how much the global supply chain was affected by the seemingly simple act of a vessel, the EVER GIVEN, being stuck in the Suez Canal for mere days.

Prior retreats from the market by banks were greeted by the growing availability of capital in the public debt and equity markets in New York or Oslo. However, while a reasonable volume of unsecured bond offerings still occurs in Oslo, the high-yield market for shipping in New York has essentially evaporated. And, while the number of New York listed public companies today dwarfs that of a decade ago, the volume of initial public offerings (IPOs) for shipping companies in

New York has slowed to a trickle. 'At the market' offerings from existing issuers keep shipping in the eyes of the investing public, but the reverse merger into a public company may be a more expeditious way to obtain a public listing for a shipping company today than an IPO. Indeed, the higher-profile developments in shipping finance over the past few years have been insolvencies and restructurings (particularly in the offshore energy and oil services sector). Meanwhile, consolidation in the industry has continued apace. Consolidation is likely to continue apace as the need to pare costs and investor pressure for market liquidity are addressed by shipping company management teams.

Moreover, prior retreats from the markets by banks were ultimately cyclical; while the absolute numbers of banks in the industry might have declined, the portfolios of the stronger banks grew into the billions of dollars. This is no longer the case and, while the geographical focus of the banking markets in shipping might have shifted from New York to London then to the European continent and Oslo, bank capital eventually returned to the market. This time the retreat seems more permanent, or if not permanent, certainly longer lasting. That is not to say there is no bank debt for shipping companies but there is certainly less of it, it is more costly and is increasingly focused on select high-credit borrowers that the remaining banks in the industry all seem to be chasing. Indeed, one will hear more discussion about 'Chinese leasing' at shipping conferences these days than banking (albeit these conferences are mostly virtual giving us all a little less transparency into what is really happening beyond our own home offices).

Shipping as an industry will continue; indeed, it must. Perhaps the future will bring us autonomous or semi-autonomous ships, but we will still need ships. There is no other way to transport commodities or finished goods in meaningful volume around the world and the world fleet will always require periodic renewal. And, of course, shipping remains a capital-intensive industry. Arguably, the demands for capital are even higher. Ships are more complex, they must be built to meet changing environmental rules, be they ballast water treatment systems or scrubbers. So, from where will the capital come to meet these demands? The market is ever changing and it is impossible to answer this question with any degree of certitude, but no one is prepared to completely write off the future of commercial banking for the shipping industry. Nor do most commentators believe the public capital markets current attitudes toward shipping are immutable. And, while much private equity capital has abandoned the industry owing to sub-par returns, the industry remains on the radar of intrepid investors who managed not to be burned by the long recovery for asset values of the immediate past cycle. And new players in ship finance continue to emerge. The number of new middle-market debt providers is on the rise. The number of institutions prepared to enter into sale and leaseback transactions has grown exponentially. Moreover, most lease transactions still have a debt element.

All this is to say is that this volume remains as relevant today as it ever has been. These new market participants and their advisers are needed to meet the challenges of a changing market. While they will

hopefully understand the need to use experienced, seasoned practitioners, this volume can provide a resource to them and answer some basic questions that an investor or lender needs to know. How can one be certain who holds what interests in the asset in question? How can one determine the precise interests of various stakeholders? How secure is a mortgage lien? What about non-vessel collateral? What obligations come with an acquisition of debt? Of what tax consequences should one be aware? What risks do future insolvencies present? These are but a few of the subjects addressed in the chapters that follow. My fellow authors and I hope you will find the answers to the questions posed helpful.

United States

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DUE DILIGENCE

Demonstrating title or legal ownership

- 1 | How does one demonstrate title to or legal ownership of a vessel registered under the laws of your jurisdiction?

Vessels – at least most commercial vessels and, in some instances, pleasure craft – are registered under the laws of the United States with the United States Coast Guard. The title to some pleasure craft is registered with the various states, but virtually all commercial watercraft, especially those trading internationally, are documented under federal law. The Coast Guard office responsible for the registration of title and the recording of liens is the National Vessel Documentation Center (NVDC) located in Falling Water, West Virginia. The NVDC maintains all records regarding title to US-flagged vessels. The NVDC will issue a certificate of ownership (Form CG-1330), which will indicate the identity of the registered owner of a vessel and will list any liens, predominantly mortgages, that have been recorded against the vessel (much like a transcript of registry available under the laws of those jurisdictions whose merchant marine laws are based on those of England). The NVDC will also issue abstracts of title (Form CG-1332), which will detail the history of all transfers and liens that have been recorded against the relevant vessel and any discharges of those liens from the date of initial issuance of a certificate of documentation for the vessel under the US flag. All transfers of title are evidenced by bills of sale.

Liens

- 2 | How can one determine whether there are any liens recorded over a vessel?

A request to the NVDC for a certificate of ownership will produce a document that will list any liens that have been recorded against a vessel. Generally, the only liens recorded are preferred mortgage liens, although, unlike many other registries, US law permits the filing of a notice of claim of lien by anyone asserting a lien against a documented vessel. Most maritime liens arise by operation of law and there is no requirement that they be recorded with the NVDC, the exception being mortgages. All vessel mortgages must be recorded with the NVDC in order to be valid 'preferred mortgages' that can be enforced by a foreclosure proceeding in the US federal courts.

- 3 | How does one determine whether there are any security agreements, liens, charges or other encumbrances granted by a vessel owner or affiliated party who might be a borrower, guarantor or other credit party in connection with a vessel finance transaction?

In order for a vessel to be registered under the US flag, the vessel (among other things) must be owned by an individual, partnership,

trust, association, corporation or other entity that meets certain requirements of US citizenship, the exact requirements depending, for example in the case of a corporation or like entity, on the nature of the registry endorsement sought. While maritime liens (other than mortgages) are by their nature inchoate 'secret' liens, not normally recorded anywhere, in cases of non-maritime liens, perfection of these liens is often accomplished by the filing of a Uniform Commercial Code financing statement (Form UCC-1) in the jurisdiction in which the liens' grantor resides – in the case of an individual, where it has its principal place of business (in the case of certain entities), or in the jurisdiction wherein the grantor was formed, in the case of a corporation or similar entity.

The actual rules can be rather complex in certain circumstances, but are comparatively simple in the instance most likely applicable in the case of financing a US-registered commercial vessel. In these instances, the relevant party is likely to be a corporation formed under the laws of one of the 50 states of the United States. If so, a creditor would perfect its security interest granted under a security agreement by a filing a UCC-1 in the state of incorporation of the debtor. Hence, in order to determine whether any such security interests exist against a party, one can perform a UCC search (there are many services that perform this function for a nominal fee) in the relevant state or states.

Public registry searches

- 4 | Can one determine whether an obligor registered in your jurisdiction is duly organised and in good standing from a search of a public registry?

Yes. If the obligor is a corporation, limited liability company or like entity, a request to the relevant jurisdiction's secretary of state's office (again, typically performed through a third-party service provider) can confirm if the obligor is in good standing (ie, it continues to exist as a legal entity and is current in its filing fees), or that it no longer is in good standing, in which case further due diligence will be required to determine the exact status of such entity.

- 5 | Can the shareholders or other equity interest holders, directors and officers or other authorised signatories of an obligor organised in your jurisdiction be determined from a search of a public registry? If not, how are these parties customarily identified?

Generally, no. Except in certain limited circumstances, there is no requirement that a list of offices or directors or shareholders be made publicly available. This is not true, of course, in the case of a publicly traded company, which must file an annual report identifying its principal executive officers. Additionally, holders of 5 per cent or more of a publicly traded US company must file a Form 13D with the US Securities and Exchange Commission. However, none of this information is customary in the case of a private company, in which instance

the information must be obtained through due diligence or by way of a certificate of someone within the subject entity's business (ordinarily the company secretary) who will certify to this information.

Debt obligation

- 6 | What corporate or other entity action is necessary for an obligor to enter into or guarantee a debt obligation? When is action by the board of directors or other governing body required? Must shareholders approve a guarantee?

Historically, guarantees of third-party obligations were considered ultra vires or beyond the scope of a company's business and, therefore, beyond its corporate power. While that concept is no longer rigidly embedded in the corporate laws of many states, the laws of some do explicitly provide that any guarantee, whether it is clearly within the intended scope of such corporation's business or not, will be enforceable if the shareholders of such corporation approve the issuance of the guarantee.

With respect to debt obligations that clearly fall within a corporation's business scope, no shareholder approval is usually required, but a determination needs to be made as to whether or not the incurrence of the debt obligation is within the ordinary course of the company's business and whether it can be stated that it is part of the day-to-day business of the company. Matters that are not ordinary, day-to-day matters should be approved by a company's board of directors or, if the corporation has delegated such power to an executive committee, the executive committee.

The laws of each US state are different and while many matters governing corporate law are consistent from state to state, not all such matters are and the laws of each relevant state should be reviewed by a qualified practitioner within such state. Moreover, each corporation will have its own unique certificate or articles of incorporation and by-laws and these need to be reviewed to make any authoritative determination regarding the foregoing.

Obligations of foreign lenders

- 7 | Must foreign lenders qualify to do business in your jurisdiction to extend credit to a borrower organised in your jurisdiction? Will foreign creditors be deemed resident as a consequence of making a loan or other extension of credit to an obligor within your jurisdiction?

As a general rule, no. Simply making loans is not considered to be 'banking', which is a complex, regulated enterprise. But the laws of each relevant state should be examined. Similarly, a lender will not ordinarily be deemed resident within the US solely by virtue of making a loan to a US-based entity or individual, but this is an area that defies generalisation and broad, sweeping conclusions of this sort are of limited value. Each case should be looked at individually.

REPAYMENT

Central bank and regulatory approval

- 8 | Is central bank or other regulatory approval required for repayment of a loan in foreign currency?

No. However, as the legal currency of the US is the dollar, the courts of most states will only award judgments in dollars.

Usury laws

- 9 | Do usury laws limit the interest payable to a lender in respect of a vessel financing?

Each state has its own usury laws, but many do not apply them for commercial transactions that meet certain size thresholds. The law with respect to ship mortgages has no independent usury limitations.

Withholding taxes

- 10 | Are withholding taxes payable on principal or interest payments to non-resident lenders?

Loans by foreign lenders to US-resident parties may be subject to withholding taxes. As a consequence of certain bilateral treaties and reciprocal exemptions in the respective domestic laws, many transactions are not subject to withholding taxes, but each transaction must be examined under federal law and the laws of the relevant state.

REGISTRATION OF VESSELS

Eligibility for registration

- 11 | What vessels are eligible for registration under the flag of your country? Are offshore drilling rigs or mobile offshore drilling units considered vessels under the laws of your jurisdiction? What is the effect of registration?

As defined in section 3 of Title 1 of the US Code, the word 'vessel' includes 'every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water'. Recent interpretations of that expression by the US Supreme Court have injected an element of uncertainty into what legal practitioners once thought was a well-settled area of law, but the prevailing view is that the definition includes offshore drilling rigs and mobile offshore drilling units.

Any 'vessel' of at least five net tons, not documented under the laws of a foreign country, is eligible for registration with the National Vessel Documentation Center (NVDC), provided it is owned by a citizen of the US. A federal registration of a vessel allows the vessel to fly the US flag and makes it eligible to become subject to a 'preferred mortgage', which is generally considered to entitle the mortgagee to superior treatment compared with state-titled vessels.

- 12 | Who may register a vessel in your jurisdiction?

A US-flagged vessel must be owned by a US citizen to be documented with the NVDC. However, there are different levels of citizenship with respect to certain entities and for certain trades. For example, a corporation seeking to register a vessel must be formed under the laws of the US or a state thereof, its chief executive officer must be a US citizen and no more of its directors may be non-citizens than a minority of the number need to constitute a quorum of the board, but the shareholders need not be US citizens. However, if the vessel is intended to be used in the US coastwise trade (or the American fisheries trade) the corporation must be at least 75 per cent owned by US citizens.

The complete rules and procedures for determining when an entity (as opposed to an individual) is a US citizen are voluminous and the foregoing is a mere example. A full analysis is beyond the scope of this summary and each case must be looked at thoroughly and independently.

Registry for international shipping operations

13 | Is there an alternate registry for international shipping operations?

No, there is no 'alternate' registry. Many US owners, both public and private, register commercial vessels with 'open' international registries such as the Marshall Islands, Liberia and Panama if there is no compelling commercial need to register those vessels under the US flag.

SHIP MORTGAGES AND OTHER LIENS OVER VESSELS

Types of ship mortgage

14 | What types of ship mortgages exist and what obligations may a ship mortgage secure? Can contingent obligations, including swap obligations, be secured? Are there standardised forms?

Generally, ship mortgages may secure loan indebtedness, whether contingent or not and, subject to certain limitations swaps and other contingent obligations but considerable care must be given to the drafting of a mortgage covering such contingent obligations as well as the methodology employed for calculating the amount of such obligations. There is no prescribed form of mortgage in the US. Unlike the English model, there is no statutory short form accompanied by a deed of covenants. Rather, a preferred mortgage typically includes the limited information required by law and National Vessel Documentation Center (NVDC), procedures and whatever covenants the parties choose to include that are not included elsewhere in the relevant debt documentation. The ship mortgage, therefore, is by practice and custom a more comprehensive document than a statutory form mortgage.

Required form

15 | Give details of any required form for ship mortgages in your jurisdiction.

While no form is required, a mortgage must:

- identify the vessel;
- state the name and address of each party to the instrument;
- state the amount of the direct or contingent obligations (in one or more units of account as agreed to by the parties) that is or may become secured by the mortgage, excluding interest, expenses and fees;
- state the interest of the grantor, mortgagor or assignor in the vessel;
- state the interest mortgaged; and
- be signed and acknowledged.

Registration of mortgages

16 | Who maintains the register of mortgages? What information does it contain and where are such filings to be made? What is the effect of registration?

The NVDC maintains the register of vessels. The effect of a proper recording of a mortgage is that it becomes a 'preferred mortgage' entitled to the priority set out in the applicable statute (formerly the Ship Mortgage Act and now codified in Title 46 of the US Code section 31322 et seq).

17 | Must the total amount of the mortgage be stated therein? Must the mortgage contain a maturity date? Must the underlying debt instrument be filed with or attached to the recorded mortgage?

The total amount of the mortgage must be stated therein. The underlying debt instrument does not need to be filed with or attached to the

recorded mortgage, but if the debt instrument is not attached, the mortgage instrument itself should set forth sufficient information to be able to allow a court being asked to enforce the mortgage (or a third party inspecting the documents on file with the NVDC) to determine what debts are in fact secured by the mortgage and in what instances the can mortgage be enforced. Hence, the practice has developed that the principal debt instruments are filed as annexes to the mortgage document itself.

18 | Can a mortgage be registered in the name of an agent or trustee for the benefit of multiple lenders?

Yes. Because of the historical antecedents of ship mortgage law, a mortgage is generally viewed at law as being a contingent grant of title to the vessel and not a mere grant of a security interest. Since a trustee can hold property for one or more beneficiaries but an agent cannot hold title for its principal, the mortgage is usually granted in favour of the collateral agent for a syndicate of banks acting in capacity as trustee.

Filings on transfer

19 | If the mortgagee is an agent or trustee for a lending syndicate, must any filings be made upon transfer of a portion of the underlying debt among existing lenders or to a new lender?

If a member of the syndicate is transferring its interest in the underlying debt to another party, no filing need be made with the NVDC unless the mortgagee itself is changing. If the latter is the case (which is typical in a bilateral loan transaction or if the agent or trustee was the principal lender and is exiting the transaction), an assignment of mortgage should be recorded with the NVDC.

20 | If the mortgagee transfers its interest to a new lender, agent or trustee what filings are required? Is the mortgagor's consent required?

The mortgage assignment should contain the same formalities as those for a mortgage, other than the requirement of a reference to a total amount.

Maritime liens

21 | What other maritime liens over vessels are recognised in your jurisdiction? Do these claims give rise to a right to arrest a vessel? In what circumstances may associated ships be arrested?

With certain very limited exceptions, any person providing 'necessaries' to a vessel is entitled to a maritime lien claim enforceable by a civil action in rem in the federal courts. What comprises a 'necessary' has been the subject of extensive litigation in the courts. Obvious necessities are fuel oil and repairs, but particular contexts give rise to more esoteric issues. Litigation has taken place in the courts over whether a fishfinder on a fishing vessel is a necessary, whether a piano is a necessary on a cruise vessel and whether seismic equipment on an oil exploration vessel is a necessary. As in the case of other areas of the law, each asserted claim must be independently examined in the context in which it arises, but one can state as a general rule that the supplier of goods and services to a vessel essential for the operation and navigation of that vessel is likely to have a lien for the supply of necessities. It is important to note that in many circumstances the US courts will look to the law of the jurisdiction in which the claim arose to determine the existence of the lien. Hence, notwithstanding the foregoing, if the jurisdiction where fuel oil was supplied to a vessel does not grant the supplier a lien under local law, the federal courts might not recognise it.

Other liens recognised under US law include:

- those for the wages of the master and the crew of a vessel and for any stevedore employed directly by a vessel;
- liens for damages arising out of maritime tort;
- liens for general average; and
- liens for salvage, including contract salvage.

22 | What maritime liens rank higher than a mortgage lien?

The following liens and any that arose before the recording of the relevant mortgage, will have priority over the mortgage, as will expenses for the vessel while in the possession of the court during a foreclosure proceeding:

- those for the wages of the master and the crew of a vessel and for any stevedore employed directly by a vessel;
- liens for damages arising out of maritime tort;
- liens for general average; and
- liens for salvage, including contract salvage.

Additionally, a lien for necessities supplied in the US has priority over the lien of a preferred mortgage on a foreign-flagged vessel.

Non-mortgage liens

23 | May non-mortgage liens be recorded over a vessel?

A party asserting a maritime lien claim against a US flag vessel may file a notice of claim of lien with the NVDC. The filing of such a notice does not alter or change the priority of the claim or, by itself, create a lien. However, creditors sometimes file these notices to create procedural hurdles for future sales of the relevant vessel or to put mortgagees and other third parties on notice of the claim.

'Foreign' flag vessels

24 | Will mortgages on 'foreign' flag vessels be recognised in your jurisdiction? If so, do they share the same priority as those on vessels registered under the laws of your jurisdiction?

Yes, assuming they were properly executed and recorded at the vessel's home port or in a central registry in accordance with the laws of such foreign jurisdiction. Except for liens for necessities supplied in the US, which have priority over the lien of a preferred mortgage on a foreign-flagged vessel, the priorities are the same.

Enforcement of mortgages

25 | What is the procedure for enforcing a mortgage in your jurisdiction by way of foreclosure? Are interlocutory sales permitted? How long does a judicial sale take? What are the associated court costs and how are they calculated?

A mortgage foreclosure proceeding is started by the mortgagee filing an ex parte motion for the arrest of the subject vessel with the federal district court of the jurisdiction wherein the vessel is found at the time the arrest is sought. If such motion is granted (upon the successful demonstration of a prima facie case), the vessel will be arrested. If the owner is unable to post a bond or other security for the mortgage claim, the vessel will remain in the custody of the court pending an interlocutory sale thereof. Once such sale occurs at a public auction any lien claims asserted against the vessel (including the mortgage lien) shall attach to the proceeds of the sale and the parties will either settle or litigate their competing claims before the court.

The length of the process is variable and will depend on the circumstances at hand, including whether the owner contests the arrest as unlawful, the court's docket and any claims brought by creditors with

respect to the setting of a minimum sales price at auction. Nonetheless, while the eventual litigation over the priority of lien claims may take upwards of a year, the process from arrest to interlocutory sale is measured in months.

Sale by mortgagee

26 | May a vessel be sold privately by a mortgagee? Will the sale discharge liens over the vessel?

While a vessel may be sold by a mortgagee at a private sale if the mortgage instrument provides for such a right, such private sale will not be deemed to discharge liens against the vessel. Such a discharge can only occur through a judicial process.

Default under mortgage

27 | Will the courts of your jurisdiction enforce mortgage provisions stipulating the appointment of a receiver on default under the mortgage?

The court in which a civil action in rem has already been commenced may appoint a receiver and authorise the receiver to operate the mortgaged vessel, but such a court shall retain in rem jurisdiction over the vessel even if the receiver operates the vessel outside the district in which the court is located. This procedure is seldom, if ever, used in the United States, and is different from the type of receiver that may be appointed under the laws of other jurisdictions.

Limitations on rights of self-help

28 | What are the limitations on rights of self-help by a mortgagee?

Self-help remedies cannot be exercised if the exercise thereof would cause a breach of the peace.

Duties to owner or third-party creditors

29 | What duties does a mortgagee owe to an owner or third-party creditors?

Generally, beyond the duty to act in good faith, a mortgagee owes no duties to an owner in default or to a third-party creditor. However, there have been cases brought in the US courts by third-party creditors that have alleged that due to its continued support of an otherwise insolvent debtor, a mortgagee was essentially a co-venturer with the vessel owner and should have its claim equitably subordinated to that of the third-party creditor. Historically, these claims have met with little success, but the risk thereof should not be completely discounted.

COLLATERAL

Finance leases

30 | May finance leases or other charters be recorded over vessels flagged under the laws of your jurisdiction?

No.

31 | May finance leases be recharacterised by a court as a financing contract? If so, is there any procedure for protecting the lessor's interest against third-party creditors?

There is always a risk in a bankruptcy proceeding that a debtor, bankruptcy trustee or third-party creditor will raise the argument that a lease – depending on its characteristics – is a financing contract, not a true lease and that the asset at issue is an asset within the estate

of the bankruptcy debtor. The consequences of such a claim, should it prevail, are serious. First, the lessor or creditor cannot seek to terminate the lease and repossess the asset. Second, the lessor may be deemed an unsecured creditor of the debtor since it will not have a recorded security interest anywhere. While parties to equipment leases involving equipment subject to the Uniform Commercial Code often file precautionary UCC-1 forms for this reason, as there is no comparable mechanism under the US Ship Mortgage Act pursuant to which a lessor may file a claim of security interest.

Security interests

32 | How is a security interest created over earnings of a vessel, charter contracts, insurances, etc? How are these security interests perfected?

These interests are created by assignments, assignments of charters, assignments of insurances or other security agreement. The security interest granted thereunder will be perfected by the filing of UCC-1 forms under the Uniform Commercial Code to the extent the collateral or the debtor are located in the United States.

33 | Must security interests against non-vessel collateral be registered to be enforceable? If so, where are such filings made?

Security interests in non-vessel collateral (subject to certain exceptions such as pledges of stock, pledges of deposit accounts and certain mobile equipment subject to certificates of title) are created by a grant of security interest pursuant to a security agreement and the filing of a UCC-1 form.

34 | How is a security interest over a deposit account established? How is a security interest perfected?

Security interests in deposit accounts are governed by article 9 of the Uniform Commercial Code. The security interest is granted by an assignment or pledge. Perfection is achieved by the secured party obtaining control over the account, usually by way of a 'control agreement' whereby the depository holding the account agrees to act pursuant to the instructions of the secured party.

35 | How are security interests in non-vessel collateral enforced?

This will depend on the nature of the collateral, particularly whether the collateral is in the possession of the secured party or a third party, or a claim. Collateral such as shares that have been certificated are usually held by the pledgee and can be sold by public auction or private sale without judicial intervention. In the case of an account pledge, notice is usually sent to the depository with instructions to remit funds in the account to the secured party. Similarly, in the case of claims for payment, notice can be sent to the account debtor with instructions to remit proceeds of the claim to the secured party. The debtor may seek court action to prevent any action by a secured party that it sees as unlawful, but (subject to a Chapter 11 bankruptcy filing) the secured party should prevail if it has been granted a security interest and has been properly perfected.

Share pledges

36 | How are share pledges for vessel financings established? Are share pledges or share charges common in your jurisdiction?

Share pledges are established by the execution of a share pledge agreement. For the share pledge thereunder to be perfected, the shares being

pledged must be delivered to the pledgee if in certificated form or made the subject of a control agreement with a securities intermediary (such as a clearinghouse or broker) if in uncertificated form.

It is custom and practice in vessel financings in the US that share pledges also require delivery of an irrevocable proxy giving the pledgee the right to vote the shares upon default, an undated instrument of transfer empowering the pledgee to transfer the shares upon default and sometimes undated letters of resignation and authority from the directors or officers. All of this is subject to certain limitations in those instances where vesting control in a non-US pledgee could violate law limiting transfer of control of US flag vessels or give rise to tax concerns, such as causing a deemed dividend of otherwise tax-deferred income (earnings of a controlled foreign corporation engaged in international shipping).

37 | Is there a risk that a pledgee, before or after exercise of the share pledge, may be exposed to debts or other liabilities of the pledged company?

The exercise of a pledge does not cause the pledgee of shares to be liable for the debts of the pledged company any more than the shareholders who pledged the shares would be in the first instance. This concern is most often raised in the oil pollution context, but unless the pledgee is exercising operational control of the relevant vessel there is little risk of liability.

TAX CONSIDERATIONS FOR VESSEL OWNERS

Domestic taxation

38 | Is the income earned by the owners of vessels registered in your jurisdiction subject to domestic taxation? At what rate?

Other than with respect to a limited class of owners of US-flagged vessels participating in the tonnage tax regime, income tax is based solely on income earned by the owners sourced within the US or on the income of the taxpayer if it is a US resident. The flag of the vessel is essentially irrelevant.

Tonnage tax

39 | Is there an optional tonnage tax exempting vessel owners from tax on income?

Subchapter R to the US Internal Revenue Code allows both US and non-US corporations to elect to be taxed in certain circumstances on the basis of the tonnage of their US-flagged fleet used in 'United States foreign trade', rather than on their income from such activities, provided the corporation is the 'operator' of one or more partially or fully self-propelled US-flagged vessels of at least 10,000 deadweight tonnage, which are used exclusively in US foreign trade.

Tax incentives

40 | What special tax incentives are available to shipowners registering vessels in your jurisdiction?

To the extent that the owners have taxable income in the US, US-flagged vessels are subject to the accelerated cost-recovery system rules allowing owners to depreciate the vessels faster than ordinary straight-line depreciation for tax purposes.

The Capital Construction Fund rules also allow owners of US-flagged vessels to shelter some income from taxation if the income otherwise subject to tax is set aside to build future vessels in the US or make capital expenditures with respect thereto. There are currently no available investment tax credits for shipping.

Other tax provisions

- 41 | Are there any other noteworthy tax provisions specifically applicable to shipping, shipping income or ship finance?

Section 883 of the Internal Revenue Code exempts foreign corporations with US-sourced income from shipping or the leasing or hiring out of a vessel from US income tax if the jurisdiction wherein the ultimate owners are based exempts US shipowners from taxation for similar activities in their jurisdiction, whether by reciprocal exemption or by tax treaty. Additionally, US taxpayers owning foreign-flagged vessels through 'controlled foreign corporations' may in appropriate circumstances defer taxation on the income earned by such corporations until it is distributed or deemed distributed back to the US shareholders.

INSOLVENCY AND RESTRUCTURING

General scheme of reorganisation or insolvency administration

- 42 | Is there a general scheme of reorganisation or insolvency administration in your jurisdiction?

Yes, in the US this would be Chapter 11 of the US Bankruptcy Code. Chapter 11, as it is widely known, is a complex scheme administered by separate bankruptcy courts in the US that has at its core the intent to provide a debtor with 'breathing space' to reorganise its business in a manner that is fair and reasonable to all stakeholders in the company subject to reorganisation. Once an entity files a petition for reorganisation under Chapter 11, there is an automatic stay that prohibits creditors subject to the bankruptcy court's jurisdiction from taking any action to enforce a claim anywhere, and this would include a foreign enforcement of a ship mortgage. Moreover, a bankruptcy may give rise to claims of lease recharacterisation or preference of fraudulent conveyances, none of which is likely to be raised outside that context.

Foreign court rulings

- 43 | Will the courts of your jurisdiction respect the rulings of a foreign court presiding over reorganisation or liquidation proceedings?

This will depend on the facts and circumstances of each case, but Chapter 15 of the US Bankruptcy Code represents the domestic adoption of the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law (UNCITRAL) in 1997. Generally, a Chapter 15 case is ancillary to a primary proceeding brought in another country, typically the debtor's home country. As an alternative, the debtor or a creditor may commence a full Chapter 7 or Chapter 11 case in the US if the assets in the US are sufficiently complex to merit a full-blown domestic bankruptcy case. In addition, under Chapter 15 a US court may authorise a trustee or other entity (including an examiner) to act in a foreign country on behalf of a US bankruptcy estate.

Model Law on Cross-Border Insolvency

- 44 | Has your jurisdiction adopted the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law?

The United States has adopted UNCITRAL's proposed model law on insolvency through the adoption of Chapter 15 of the United States Bankruptcy Code.

Order of priority

- 45 | What is the order of priority among creditors? In what circumstances will creditors be required to disgorge payments from an insolvent company?

These questions cannot be answered summarily. Secured creditors are clearly treated in a superior manner to unsecured creditors, who are in turn treated in a manner superior to equity holders, but under Chapter 11 the determination of who is a secured creditor and who is not requires a complicated analysis that is very much dependent on the facts of the case. Such analysis is, however, often the most contentious part of a bankruptcy proceeding.

Disgorgement of payments from an insolvent company in the US is the subject of the 'preference' rules in a Chapter 11 proceeding. To the extent this subject can be broadly articulated, it can be stated that a payment made outside the ordinary course of business within the 90 days preceding a Chapter 11 filing may be set aside as a preference and that the party receiving such a payment may be ordered to disgorge it. An example of such a preference might be the early payment of a debt to one creditor that has the effect of granting that creditor preferential treatment with respect to others.

Security provision by vessel owner

- 46 | May a vessel owner provide security on behalf of other related or unrelated companies? What are the requirements for it to be enforceable?

Yes, subject to such provision of security not being ultra vires, a preference or a fraudulent conveyance.

Law of fraudulent transfer

- 47 | Is there a law of fraudulent transfer that permits a third-party creditor to challenge, for example, the grant of a mortgage because of insolvency of the mortgagor or insufficient consideration received by the mortgagor in exchange for the grant of the mortgage?

Yes. As a general rule, both in bankruptcy and under state law, a third-party creditor may challenge a transaction providing for the grant of security if the grantor was insolvent at the time of the grant and did not receive a fair consideration (reasonably equivalent value). The tests for both insolvency and fair consideration can be complex.

Petitions by creditors

- 48 | How may a creditor petition the courts of your jurisdiction to declare a debtor bankrupt or compel liquidation of an insolvent obligor?

Any two or more creditors may petition to commence an involuntary bankruptcy petition against a debtor.

Model Netting Act

- 49 | Has your jurisdiction adopted the Model Netting Act of the International Swaps and Derivatives Association (ISDA)? If not, may a swap provider exercise its close-out netting rights under an ISDA master agreement despite an obligor's insolvency?

The US Bankruptcy Code has provisions that specifically allow for netting of obligations under ISDA swap and derivatives transactions.

UPDATE AND TRENDS**Current developments**

- 50 | Are there any emerging trends or hot topics that may affect shipping finance law and regulation in your jurisdiction in the foreseeable future?

Recent case law in the United States, specifically, *Barnes v Sea Hawaii Rafting*, in the Ninth Circuit Court of Appeals, has renewed debate about the power of a bankruptcy court in the United States to adjudicate maritime lien claims, including whether a vessel under section 363 of the US Bankruptcy Code can be sold free and clear of all liens in the same way a United States district court can pursuant to the admiralty jurisdiction granted thereto under article III of the United States Constitution. This is a matter on which the United States Supreme Court has yet to speak. This decision comes at a time when various actions taken by bankruptcy courts in the United States were leading practitioners to question whether traditional maritime remedies would continue to be relevant. *Barnes* tells us that – for now – they are.

Additionally, with the increasing use of financing leases in sale and leaseback transactions in the current market, the issue of recharacterisation of leases as finance contracts is likely to become a hot topic in the very near future.

Coronavirus

- 51 | What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

With rare exception, the covid-19 relief programmes adopted in the United States have not been industry specific. As vessel security interests, including ship mortgages, are able to be filed electronically, procedures did not need to be altered because of covid-19. What has been helpful is the many states have temporarily allowed for notarisation of documents via video conferencing. Since vessel mortgages must be acknowledged before a notary and in person closings have been difficult this development has been most helpful.

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