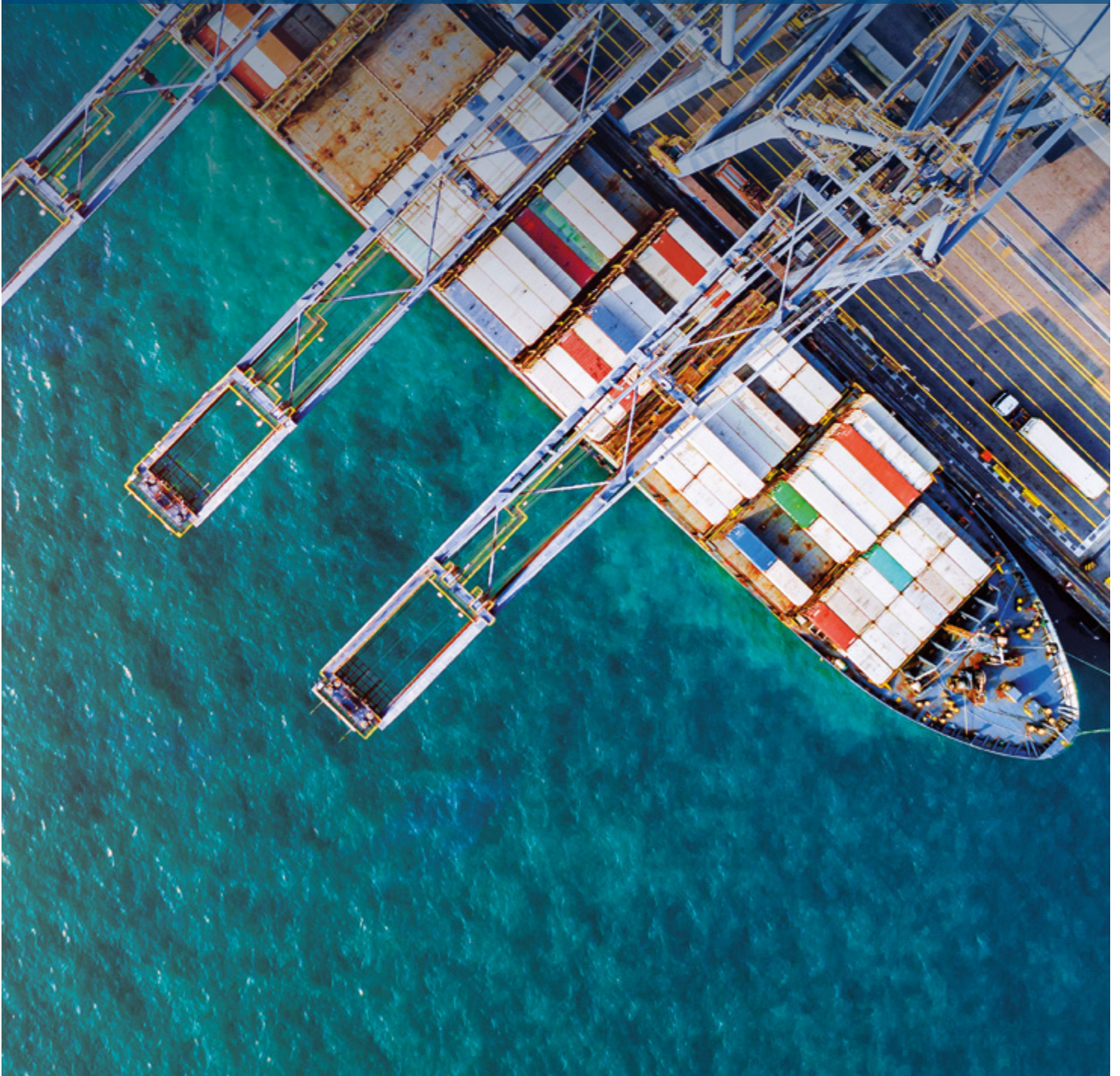


MAYER | BROWN

Ship Finance

Mortgage Enforcement



It is impossible to give general advice as to which would be the appropriate method of enforcement in each case, because each vessel will be in a different situation, presenting a variety of possibilities and different problems.

Here we discuss some of the factors which a mortgagee will have to bear in mind, and then outline some of the possible steps which it might take. We also point out some of the pitfalls and disadvantages of taking a particular action in some circumstances.





Relevant Factors

WHAT IS THE EMPLOYMENT OF THE VESSEL?

If the vessel is on bareboat charter, there should be some direct contractual relationship between the lender and the bareboat charterer, and this is likely to assist in determining what are the rights of the lender to interfere with the bareboat charterer's quiet enjoyment.

If the vessel is on time charter, there will be a charterer who may wish to preserve the charterparty and to continue to use the vessel (if the rate is lower than the current market rate) or may be very keen to terminate the charterparty either by negotiation or unilaterally, if the contractual rate is higher than the market rate. Under a time charter, the Charterer determines the trading pattern of the vessel and the ports at which she will call.

If the vessel is being traded on voyage charter terms or on the "spot market", the owner will be paying for (or not as the case may be) all the expenses of fuel, tugs, pilots and stevedores and will collect only a lump sum freight from the owner of the cargo.

However, in those circumstances, it is the owner who decides on the trading pattern of the vessel and he can sometimes be persuaded to co-operate in sending the vessel to a convenient jurisdiction.

The last common situation is that the vessel is engaged on a liner trade plying a regular route. If the ship is for example a container ship, it is likely that she will always have a certain amount of cargo on board. The Owners of that cargo will be most displeased if the ship is arrested and does not therefore deliver their cargo and may well pursue claims against the shipowner (but to what benefit) and may also try to make life difficult for the mortgagee.

THE TRADING PATTERN OF THE VESSEL

If the vessel does call frequently at jurisdictions where the mortgagee can easily enforce his mortgage by an arrest of the vessel, then that may well provide a useful option for the mortgagee. However, if the vessel is continually trading between jurisdictions with undeveloped legal systems or where the mortgagee's claim does not enjoy priority status, the mortgagee may well be advised to employ alternative methods.

THIRD PARTIES WHO MAY BE AFFECTED BY YOUR ACTIONS

The principal categories of these are Charterers and cargo owners (who may or may not be the same persons). If the vessel is let on time charter, the Charterers may be very keen to have the vessel arrested and to be able to terminate the Charterparty. Equally however if they have contracted to deliver cargo to a specific destination and for legal or commercial reasons have to do so, they may well seek to recover any additional costs of doing so in terms of trans-shipment costs or increased hire periods from the mortgagee whose actions have interfered with the Charterparty.

In general terms, a mortgagee is only entitled to take steps which affect the contractual obligations of the vessel when either the owner is himself unable to perform the Charterparty (e.g., he needs a further advance from the mortgagee to meet the running expenses) or if the contract imperils the security of the mortgagee.

This second category does not include simply the Charterparty being a bad commercial bargain which does not cover the cost of the vessel or that the vessel will end up in a jurisdiction which is unfavourable for the enforcement of the mortgagee.

Cargo owners also usually require their cargo to be on-carried to destination if at all possible. Although under English type jurisdictions if the vessel is arrested, the cargo interests have to bear the costs of trans-shipment and on-carriage of the cargo (which form a non-priority claim against the ship-owner who is likely to be insolvent anyway) other jurisdictions have different rules of procedure and priorities.

Also if it is a high bulk but low value cargo, the cargo owner may prefer simply to abandon the cargo, leaving the mortgagee faced with the cost of financing discharge of the cargo and its storage pending sale to try to recover the cost of doing so, always assuming this is physically possible.

In general terms, it is much more convenient if the ship is empty of cargo when the mortgagee comes to enforce his security.

THIRD PARTIES AFFECTING THE MORTGAGEE'S ACTIONS

You may well not have the luxury of choice as to which jurisdiction to select for enforcement.

The ship may well be arrested by other claimants such as bunker suppliers, agents, tugs, pilots or stevedores who have been unpaid. There may be cargo claims against the vessel leading to her arrest. Although most such cargo claims will be covered by the P&I Club who can be called upon to provide security for the claim so as to have the ship released, they do not cover all claims (e.g., claims for misdelivery of cargo) and it may well be that the owner has not paid his insurance premia or calls.

If any other claimants have arrested the ship in a particular jurisdiction, the mortgagee should think carefully whether that is also a convenient jurisdiction from his point of view, or whether those claims will enjoy priority over the mortgagee's claim in which case he may well be advised to settle those competing claims to enable the ship to be taken to a better jurisdiction.

The usual form of mortgage conditions and detailed Deed of Covenants does give power for the mortgagee to advance such funds on behalf of the shipowner, and include them in the amount outstanding under the mortgage.

Possible Methods of Enforcement

Having considered all the above factors, it is then necessary to decide which one or more of the following possible methods of enforcement might be appropriate.

It is important to note that before some or all of the following steps are taken, it will have been necessary to serve either a Notice of Default or Notice of Acceleration (depending on the form of lending) providing that the entire outstanding indebtedness is due and repayable. Whether or not such a Notice can be served at that time and the appropriate method of service will be governed by the terms of the Loan Agreement and/or Mortgage. Any procedural requirements e.g., notice by email, must be strictly complied with. It is not, generally, necessary to show that a reasonable opportunity has been given for the borrower to remedy any default (e.g., by giving 7 days to make payment of an outstanding amount) provided that it is physically possible for the payment to be made or other steps taken to remedy the default within the time limit specified.

ARREST OF THE VESSEL AND SALE THROUGH THE COURTS

This option will depend upon the vessel being in an appropriate jurisdiction which has a favourable procedure and grants to the mortgagee priority over virtually all the competing claims.

Generally under English type jurisdictions, a registered mortgagee enjoys a substantial degree of priority after only the cost of enforcement, crew wages, salvage and damage claims. The latter two are of course normally met by the insurance on the vessel.

Other potential claimants such as cargo owners, suppliers of equipment or services to the vessel or repairers do not enjoy priority. Also as indicated above, the obligation for the discharge and on-shipment of any cargo on board the vessel falls in the first instance on the owners of cargo.

There are two important advantages in a Court sale.

- The first is that the vessel is sold free and clear from all encumbrances, whether registered or not, such that the vessel should, by convention, be protected in the hands of new owners from any claims against the old owners, even if those

claims have the status in any jurisdiction of a maritime lien or were protected by the issuance of proceedings before the sale took place. Of course if the sale is to a third party, it does not concern the mortgagee in any event if a claimant does arrest the vessel in new ownership, because it is the Court and not the mortgagee who gives any warranty of freedom from encumbrances in the Bill of Sale.

- The second advantage is that a Court sale, properly advertised and conducted, will usually protect a mortgagee against any claim for sale at an under-value or in breach of his duty of good faith to the mortgagor to obtain the best price for the vessel.

There is generally no prohibition on a mortgagee purchasing the ship himself (usually by means of a subsidiary company) and then selling at arms length on private terms. Generally vessels sold at Court sales do not achieve the best possible price but a mortgagee can substantially protect his interests by this method. The distribution of the proceeds of sale paid into Court will be the subject of a determination of priorities in accordance with the rules in that jurisdiction.

FORECLOSURE AND SALE

Under certain Registries, and in practical terms with the consent of the borrower or with the benefit of a Court Order, a mortgagee can exercise statutory powers of foreclosure and sale.

However such sale will be subject to other encumbrances against the title, and the mortgagee will have to warrant that there are no other outstanding claims which might be enforced against the vessel. The only real benefit of adopting such a course of action would be if the procedures in the jurisdiction where the vessel is located do not favour a Court sale.

A mortgagee acting in such circumstances must also be careful to ensure that he sells at the best price reasonably obtainable, which is usually ascertained by obtaining appropriate brokers valuations.

Under English law principles, the mortgagee cannot buy the ship himself. If he does buy through an associated or subsidiary company over which he exercises substantial control, he will have the burden of proving that the sale price was fair and proper, otherwise the sale may be set aside or he

may be liable to the borrower in damages for any under-value. An allegation of sale at an under-value would quite probably be made in defence of any claim by the mortgagee to recover any shortfall under a personal guarantee or other security.

ENTERING INTO POSSESSION

Most Mortgages or Deeds of Covenants will give this right to the mortgagee.

However by doing so, the mortgagee becomes liable to perform the contracts of the shipowner (e.g., the Charterparty) and also becomes personally liable for all future debts of the vessel.

Generally therefore this is likely only to be a fairly short term remedy to enable the mortgagee to give instructions to the Master to take the vessel to an appropriate jurisdiction for arrest and sale.

There can also of course be practical difficulties in taking physical possession if for example the ship is not in port at the time or the Master on instructions from the borrower refuses to co-operate. However, it is frequently the case that the Master and crew are owed substantial arrears of wages by the time the mortgagee comes to enforce his mortgage, and a promise of prompt payment of those arrears of wages can often secure co-operation from the Master and crew.

EXERCISE OF PLEDGE

This allows the mortgagee to take over the control of the shipowning company, appoint his own shareholders and directors and control the vessel.

This can often be useful for the purpose of retaining a favourable Charterparty although a Charterer in those circumstances is likely to seek every possible avenue for termination.

Future liabilities of the ship remain the responsibility of the shipowning company (rather than the mortgagee personally).

However, there can be certain statutory obligations and liabilities which could make a mortgagee personally liable for claims arising out of the operation of the ship whether he is in possession or controlling the shipowning company through his nominees. The most serious potential liability is under the U.S. Oil Pollution Act or similar state legislation where a mortgagee may well be determined to be a "responsible person" particularly under the deep pocket concept.





Conclusion

The foregoing is not a comprehensive analysis of the security and powers of enforcement which may be enjoyed in all cases. The mortgagee will have other powers, such as the right to appoint a receiver or the right to lay-up the ship. It may also have other security, such as an account charge, corporate guarantees and collateral security assets.

Before you reach the stage of calling an event of default and enforcing your security, it is important to carry out a review of your powers and any restrictions on them. Having carried out such a review, you can formulate a strategy to protect the bank's interests and mitigate any loss which it may suffer.

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