

Ship Finance

In 21 jurisdictions worldwide

Contributing editor
Lawrence Rutkowski



2015

GETTING THE
DEAL THROUGH

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Ship Finance 2015

Contributing editor
Lawrence Rutkowski
Seward & Kissel LLP

Publisher
Gideon Robertson
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Business development managers
Alan Lee
alan.lee@lbresearch.com

Adam Sargent
adam.sargent@lbresearch.com

Dan White
dan.white@lbresearch.com



Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3708 4199
Fax: +44 20 7229 6910

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First published 2014
Second edition
ISSN 2056-4015

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



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Gennaro Mazzuocolo Norton Rose Fulbright Studio Legale		Lawrence Rutkowski Seward & Kissel LLP	

United Kingdom

Tony Rice and Ian Hughes

Holman Fenwick Willan LLP

Due diligence

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

For a fee of £21 a transcript of registry is available from the Registry of Shipping and Seamen. This transcript will show details of the ship, the name and address of the current ownership and shareholding in the ship and details of any mortgages over the ship.

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

The transcript of registry only shows any mortgages registered over a ship. Liens do not need to be registered under English law.

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?

See questions 1 and 2. A transcript of registry will demonstrate whether a mortgage has been granted over the ship and registered. However, unregistered mortgages are possible.

If the shipowner is a company registered in the United Kingdom a search of the Companies House register for the relevant part of the UK will reveal any fixed or floating charges granted by the shipowner and registered.

A writ search can be carried out at the Admiralty and Commercial Court for a fee of £10 to determine whether any claims have been commenced against the ship. This may demonstrate any encumbrances over the ship.

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?

A search on the Companies House website will show key information such as the registered office, date of incorporation, insolvency actions registered against the company and key future filing dates. Company accounts and annual returns can also be accessed for a £1 fee. However, the accuracy of Companies House data is reliant on companies making filings.

Good-standing certificates can be ordered from Companies House. A good-standing certificate will state that a company has been in continuous, unbroken existence since its incorporation and that no action is currently being taken to strike the company off the register. An incorporation certificate can also be requested, certifying the names of directors, the secretary and shareholders, issued capital and company objects.

A search at the Bankruptcy and Companies Court will determine whether any proceedings have been lodged against a company. This can be done using the search computers at the Bankruptcy and Companies Court (a £10 fee is payable) or by telephone.

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?

Details of a company's directors, officers, secretary and shareholders will be listed on the company's annual return, which can be requested from Companies House. Companies House also maintains an accessible register of company secretaries and directors, and companies are required to make filings upon a change of any director or secretary for the purposes of this register. However, as mentioned above, the accuracy of Companies House data is reliant on companies making the required filings in a timely manner.

Companies are also required to keep a register of directors and a register of shareholders, which must be kept at the company's registered office or at a single alternative inspection location. Any person is entitled, on payment of a prescribed fee, to inspect these registers.

The register of shareholders maintained by the company and the annual return will identify only the registered shareholders. They will not identify whether the registered shareholder is holding them as a nominee for another, nor describe any equitable interests that exist. Prior to 26 May 2015 bearer shares were also permitted, though not common, and it may not have been possible to identify the current holder of these from the public record. As of 26 May 2015 the creation of bearer shares is prohibited and a nine-month voluntary surrender period has commenced whereby the holder of any bearer shares can surrender these to the company in question for conversion into registered shares.

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?

Entry into a debt obligation or guarantee must be duly authorised by the appropriate corporate action. Typically this will be by means of a resolution of the board of directors, although the board may delegate powers to individual directors or others to enter into such obligations on behalf of the company. A shareholders' resolution is not usually required either for guarantees or loans unless the loan is made to a director or the guarantee is given on his or her behalf. Shareholder approval may also be appropriate if the directors have doubts as to whether a transaction is of benefit to the company and, therefore, if the transaction would be a proper exercise of their powers.

The company's articles of association or other constitutional documents may place restrictions on the giving of guarantees or impose procedures that must be followed in order to authorise the entry into a debt or guarantee obligation, but (subject to exceptions relating to transactions involving directors) in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution (section 40, Companies Act 2006).

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?

Foreign banks or other lenders do not need to seek UK regulatory approval to extend credit to an English company, and there are no exchange controls in place that would restrict payments from an English company to such foreign lenders. Corporate lenders will not be deemed UK-tax resident unless they are incorporated in the UK or are centrally managed and controlled here. A non-resident company that trades through a UK permanent establishment is liable to pay UK corporation tax on the profits arising from that permanent establishment. However, please also note question 10 in relation to withholding tax on interest payments.

Repayment

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

Regulatory approval is generally not required for repayments of a loan in foreign currencies, subject, however, to any international sanctions that may be applicable to the currency in question. Anti-money laundering and anti-terrorism regulations will also need to be complied with.

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

Lenders granting loan facilities governed by English law need to exercise caution when setting the rate of interest payable if the borrower is in default of its obligations. General English law contractual provisions will apply including common law rules on clauses deemed to be a penalty and, therefore, unenforceable. Whether a clause setting out the default rate of interest would be deemed to be a penalty would be decided by the courts on a case-by-case basis; however, there are established case law principles to follow, namely: (i) that default interest can only be charged while the default is continuing unremedied; and (ii) that the rate should be reasonable in terms of the current market (see *Lordvale Finance plc v Bank of Zambia* [1996]). Default rates of between 1 and 2 per cent above the contractual rate of interest applicable to the loan facility in question are common market practice in English law ship finance loan agreements.

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

Payments of principal are not subject to UK withholding tax. However, payments of interest by a UK-based borrower to a foreign lender are subject to a 20 per cent withholding tax at source. This rate may be eliminated or reduced under the terms of a double taxation treaty, or under the EU Interest and Royalties Directive in the case of EC lenders. The lender must make a formal application to the UK tax authority (HMRC) for approval to receive interest gross or at a reduced rate of withholding tax, and until the borrower has been notified by HMRC that a reduced rate of withholding tax applies, the borrower must deduct a 20 per cent withholding tax before payment to the lender. A list of all the countries with which the UK has entered into double taxation treaties can be found at www.hmrc.gov.uk/taxtreaties/in-force/index.htm. In ship finance transactions, lenders will typically require that a tax gross-up clause be included in the loan documentation.

Registration of vessels

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?

The UK Ship Register (the Register), which is maintained by the Maritime and Coastguard Agency (MCA), is split into four parts depending on the type of ship:

- Part I – merchant vessels and pleasure vessels or large yachts over 24 metres;
- Part II – fishing vessels;
- Part III – Small Ships Register for ships under 24 metres; and
- Part IV – bareboat charters of foreign-flagged vessels that are chartered on bareboat charter party terms by a charterer.

A ship may not be registered in more than one part of the Register and the MCA does not permit the registration of ships under construction.

The Merchant Shipping Act 1995 provides that ‘ship’ includes every description of ship used in navigation (section 313). It is unclear under English law whether offshore drilling rigs or mobile offshore drilling units would be classified as ships. It is important whether such structures are classified as ships or not because the regulatory regimes that apply to ships are different from those that apply to non-ship structures.

There are no age restrictions on ships registered with the Register. However, ships over 15 years old must be approved by the MCA’s technical experts before they can be registered.

The MCA has the power to refuse to register a ship, even if it is eligible for registration, on the grounds that the ship does not comply with environmental or safety requirements.

There is no legal requirement to register a ship under the UK flag. However, an owner will usually register a ship so that jurisdiction can be established over the ship. International law provides that all ships using the high seas must possess a national character. Registration will also provide evidence of the ship’s nationality, it will confer the right to fly the national flag and will provide the right to naval protection, diplomatic protection and consular assistance. It will also provide prima facie evidence of the title of the registered owner and of registered mortgages. From a lender’s perspective, registration is required in order to ensure that a mortgage can be registered against the ship on the Register, thereby enabling mortgagees to protect their interest.

12 Who may register a vessel in your jurisdiction?

The ownership of a UK ship is divided into 64 shares. The Merchant Shipping Act 1995 provides that, in order to be registered as a UK ship under Part I of the Register, at least 33 of the shares (the majority interest) in the ship must be owned by persons or a company qualified to own UK ships (a qualifying owner). To be a qualifying owner the persons or company must fit into one of the following categories:

- British citizens;
- British Dependent Territories citizens;
- British citizens living overseas;
- citizens of an EU member state exercising their rights under article 48 or 52 of the EU Treaty in the United Kingdom;
- companies incorporated in one of the European Economic Area countries;
- companies incorporated in a British overseas possession having their principal place of business in the United Kingdom or in that overseas possession; and
- European economic interest groupings.

Where more than one qualifying owner of the ship is resident in the UK, one of the qualifying owners will be appointed the managing owner of the ship and will receive all correspondence from the MCA.

If none of the qualified owners are resident in the UK, a representative person must be appointed who may be either an individual resident in the UK or a company incorporated in one of the EEA countries with a place of business in the UK.

There are additional requirements for registration of fishing vessels and small ships.

All applications for registration shall be made to the Registrar at the Registry of Shipping and Seamen. Registrations can be made in person or by post and must be supported by a declaration of eligibility in the approved form, which shall include a declaration of British connection, a declaration of ownership by every owner setting out his or her qualification to own a British ship and a statement of the number of shares in the ship, the legal title of which is vested in each owner.

13 Is there an alternate registry for international shipping operations?

There is no alternative registry for international shipping operations that allows for foreign ownership of ships registered in the UK.

However, if an overseas company opens an establishment in the UK or has some degree of physical presence in the UK, for example, a place of business or a branch through which it carries on business, the overseas company must register with Companies House. See Part 34 of the Companies Act 2006 and the Overseas Companies Regulations 2009/1801 for further information.

Ship mortgages and other liens over vessels

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?

The UK statutory forms of mortgage generally fall into two categories, those securing 'principal sum and interest' only and those securing an 'account current or other obligation'. Ship mortgages can be granted by an owner to secure their own obligations whether as principal debtor or as guarantor of another party's obligations, although where a third party granting a ship mortgage is a UK company lenders should ensure that the English law corporate benefit tests are met. Because principal sum and interest mortgages will not secure contingent or other liabilities beyond principal and interest payable under the loan, it is 'account current or other obligation' mortgages that are usually used in ship finance transactions. The current pro forma UK statutory mortgages are issued by the MCA. These contain limited information, and although English statute and common law provides mortgagees with a number of general rights if the owner defaults (such as the right to take possession of the ship, the right of sale, the right to appoint a receiver, the right to foreclose and the right to arrest the ship), it is usual that a lender will also require that a deed of covenants 'collateral' to the ship mortgage be executed. This will set out the lender's rights and powers in more detail. The deed of covenants is not registrable with the MCA. However, if the owner is a UK company, the deed of covenant, together with the ship mortgage, must be registered at Companies House to ensure the lender's priority (see question 17).

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

The Merchant Shipping Act states that a registered ship mortgage must be in one of the forms prescribed pursuant to that Act and published on the MCA website, www.dft.gov.uk/mca.

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 register of mortgages over UK ships is the responsibility of the centralised Registry of Shipping and Seamen in Cardiff, Wales (the Registry). Filings are made to the Registry.

A mortgage creates a fixed security over the ship, which attaches to the ship in rem. The mortgage will survive a change of ownership. It entitles the lender to sell the ship and use the sale proceeds to pay off the amount owing to it if the owner is in default. Under the Merchant Shipping Act every registered mortgagee shall have power, if the mortgage money or any part of it is due, to sell the ship or share in respect of which he or she is registered, and to give effectual receipts for the purchase money.

Mortgages are registered in the order in which they are produced to the registrar for the purposes of registration. Registration gives the mortgagee higher priority over unregistered mortgagees. This is so irrespective of whether the unregistered mortgage was created first and is irrespective of knowledge. Where more than one mortgage is registered against the same ship or share, the priority of the mortgages between themselves shall be determined by the order or time in which the mortgages were registered, the earliest registered mortgage having priority.

Failure to register a mortgage does not render the mortgage void. However, an unregistered mortgage will be an equitable mortgage and an unregistered mortgagee will not have priority over a subsequent registered mortgagee.

Under English law, any person who is an intending mortgagee under a proposed mortgage may notify the registrar of the intended interest, and the registrar shall record that interest. This is known as a 'Notice of Mortgage Intent' (form MSF 4739). A priority notice has effect for a period of 30 days. If the mortgage is executed and registered within 30 days and during that time another mortgage has been registered, the mortgagee with the priority notice will take priority over the other mortgage even though it has been registered first.

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?

In rare circumstances where the 'Principal sum and Interest' statutory mortgage is used, it is necessary to state the amount of the loan. Neither

the total amount of the mortgage nor the maturity date need to be stated in the 'account current' mortgage.

It is only the original mortgage instrument that must be presented when registering the mortgage with the Registry - neither the underlying debt instrument nor the deed of covenants need to be filed or attached to it. The Registry will endorse the mortgage with the date and time of its registration and then it will be returned to the mortgagee.

Where the owner is a UK company, the mortgage and deed of covenants should also be registered with Companies House within 21 days of creation of the charge.

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

Yes, the Registry will accept for registration of a mortgage in favour of an agent or trustee (or, under English law, more commonly known as a security trustee) for the benefit of multiple lenders.

19 If the mortgage 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?

English law has well-established principles of trust and agency. If a syndicate of banks have put a trust structure in place whereby one of those lenders acts in a separate capacity as security trustee for itself and the other syndicate members, then for so long as the security trustee remains appointed in this capacity, security will not need to be amended if any of the syndicate banks (including the security trustee in its separate capacity as lender) sells or otherwise transfers its loan commitment to another lender.

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 UK statutory form of mortgage can be transferred to a new mortgagee if the outgoing mortgagee completes and signs the form of transfer contained in the statutory mortgage and lodges this with the Registry. The Registry would not require evidence that the mortgagor has consented to this transfer. However, the loan documentation may have been negotiated in such a way that the lender or lenders may have to seek the borrower's consent to any transfer of commitment or of the underlying security. If the lenders in question also benefit from a deed of covenants this will need to be transferred to the new security trustee (and details of the amendment filed with Companies House for UK borrowers).

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?

Under English law, there are five main categories of maritime lien:

- salvage remuneration;
- damage done by a ship;
- master and crew wages;
- master's disbursements; and
- bottomry and respondentia (largely redundant).

These claims give rise to an action in rem against a ship and a right to arrest a ship.

Maritime liens operate as a charge on the ship that will follow the ship notwithstanding a change of ownership. This is so even where a purchaser is a bona fide purchaser for value without notice of the claim. As maritime liens survive the sale of a ship, this may operate to allow the arrest of a ship even if it has changed ownership. This is because the lien attaches to the ship at the time the cause of action arises and will remain attached until satisfied or time-barred.

It is also possible to arrest a sister ship of a ship that is subject to a maritime lien if the owner of the sister ship was the owner or demise charterer or bareboat charterer, or in possession or control of that ship, when the cause of action arose in relation to the defendant ship; and that person or entity is also the beneficial owner of all the shares in the sister ship when the claim is commenced.

The Senior Courts Act 1981 sets out a list of maritime claims that give rise to a statutory right of action in rem against a ship. These are commonly referred to as statutory liens and these also give rise to a right to arrest a ship.

22 What maritime liens rank higher than a mortgage lien?

Claims for all of the liens set out in question 21 will rank higher than a registered mortgage, even if they arise after the mortgage has been created or registered. A possessory lien (eg, a shipowner's right to retain possession of cargo until monies owed to it by the ship's charterer have been paid) will also rank higher than a mortgage lien.

Typically, a mortgage will have priority over statutory liens unless a claim has been made and a writ in rem has been issued against the ship prior to the date of the mortgage.

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

Non-mortgage liens may not be recorded or registered over a ship under English law.

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, in the United Kingdom, mortgages on 'foreign' flag ships are recognised. The priority of the foreign mortgage will be the same as if it had been a similar mortgage over a UK-flagged ship.

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?

If the owner is in default under the mortgage documents, the mortgagee has the right to apply to the court for the arrest and sale of the ship if it is located within UK territorial waters. The Admiralty Court in England and Wales has jurisdiction over all ships in UK territorial waters irrespective of their flag.

To arrest the ship, the mortgagee must issue its claim in the Admiralty and Commercial Court Registry. The claim form must then be served by fixing it on the ship. Usually the mortgagee will apply for the issue of a warrant of arrest at the same time as issuing its claim. For the court to issue a warrant of arrest the mortgagee must file an affidavit setting out, among other things, the details of the mortgage and the default in payment by the owner. The mortgagee must also provide an undertaking to meet the costs of the Admiralty Marshal. Upon receipt of the application and the payment of the fees, the warrant of arrest will be issued and the Admiralty Marshal will serve the warrant of arrest. After the arrest, the ship remains in the custody of the Admiralty Marshal until it is released or sold by the court.

The mortgagee may make an application to the court for an order for sale. Once the order has been made, the ship will be valued and ship brokers will be instructed to advertise the sale in the trade press. Potential buyers will usually inspect the ship and make sealed bids. The ship will then be sold for the highest bid (if the mortgagee finds a buyer privately, the court may, in exceptional circumstances, allow for the ship to be sold to that buyer, though recent case law has further limited the scope of such 'private' sales). Once the ship is sold, the proceeds of sale are paid into court. The Admiralty Marshal will submit his or her expenses and apply for leave to pay these expenses from the fund in court. The mortgagee will then apply for judgment for an order for the payment out of the proceeds of the court.

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

Yes, under English law a ship may be sold through the court or privately by the mortgagee pursuant to the powers given to it under the mortgage documents. The private sale by the mortgagee will not discharge liens over the ship unless they are discharged from the proceeds of sale.

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

See question 14 regarding the lender's powers set out in the deed of covenants collateral to the mortgage.

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

With regard to a private sale of a ship by the mortgagee, it must take all reasonable steps to obtain the best price reasonably obtainable for the ship (*Tse Kung Lam v Wong Chit Sen* [1983]) and account to the owner for any balance remaining once the amounts due have been discharged.

Collateral**29 May finance leases or other charters be recorded over vessels flagged under the laws of your jurisdiction?**

The only interests that can be registered against a UK-flagged ship are mortgages (see question 14). Therefore, there is no way to record a finance lease or charter against a ship on the Register unless obligations under those documents were secured by a mortgage against the ship, which, generally, is unlikely.

30 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?

Where the party that has sold the asset and leased it back has a right against, or an obligation to, the buyer or lessor to retake title to the asset at the end of the lease, for example, by paying an option price, it is possible that a court may re-characterise the lease as a secured financing contract or loan. However, English courts are unlikely to do this unless there is evidence that the sale and finance lease documents do not record the true commercial motivations of the parties. The lessor may seek indemnities from the lessee to guard against such a risk.

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

Security interests over earnings of a ship, charter contracts and insurances can be created by means of an assignment. In order to be effective as a legal assignment under section 136 of the Law of Property Act 1925, the assignment must be in writing, signed by the assignor and it must be absolute, and not purporting to be by way of charge only. Only the benefit of an agreement may be assigned. In addition, written notice of the assignment must be given to the debtor (eg, the charterer in an assignment of earnings and the insurer in an assignment of insurances). If the assignment satisfies these requirements, the legal right to the debt, all legal and other remedies for the recovery of that debt and the power to give good discharge without involving the assignor, transfers to the assignee. If the assignment does not fulfil all of these requirements, it does not necessarily fail. It is likely to operate as an equitable assignment. The disadvantages of this are that the lender cannot give a good discharge for the debt without the agreement of the borrower and the lender cannot sue the debtor without joining the borrower into the action.

Alternatively, these security interests can be created by means of a fixed or floating charge. Any charges over UK-flagged ships must be registered with Companies House in order to ensure they take priority. Fixed and floating charges are discussed in more detail in question 33.

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

The two most common types of security interest against non-ship-related collateral are security over the borrower's shares, and security over a bank account. Security interests over bank accounts are discussed in question 33.

Ship finance lenders will often take a charge or pledge over the shares in the borrower company. A share pledge is the appropriate form of security where shares are in bearer form. A share charge is used where shares are registered. The main advantage of a share charge or pledge is that following an event of default (see question 34), the lender will be able to sell the shipowning company as well as the ship itself.

In order to secure priority a share charge or pledge should be registered at Companies House. Although some security created over shares may be subject to the Financial Collateral Arrangements Regulations 2003, which provides that the security does not need to be registered, most practitioners still take a cautious view and register the security at Companies House.

33 How is a security interest over a deposit account established? How is a security interest perfected?

A security interest over a deposit account is usually taken by way of a fixed or floating charge.

A fixed charge gives the security taker control over the charged asset. If the security taker does not have sufficient control over the asset, the charge will be floating and not fixed, even if this was not the intention of the parties. In order for a fixed charge to be taken over a bank account,

the account holder must not be able to deal with the money in the charged account without written permission from the security taker. If the account is being used frequently in the course of the account holder's business this restriction may be impracticable.

A floating charge over an account provides the security taker with less security than a fixed charge because a floating charge-holder is only paid out of asset realisations after fixed charge-holders, the expenses of the insolvent estate, and any preferential creditors have all been paid in full and a percentage of the remaining assets has been ring-fenced for payment to unsecured creditors (see question 43). However, a floating charge is often preferred because it allows the account holder more control over the money in the account. The account holder is free to withdraw funds from the charged account without the security taker's consent.

A fixed or floating charge over a deposit account can be perfected by registering the particulars of the charge at Companies House.

34 How are security interests in non-vessel collateral enforced?

Ship finance loan agreements will set out the circumstances, usually named collectively as 'events of default', upon the occurrence of which the lender can accelerate the loan and enforce its security. Depending on how the documents are drafted or negotiated, the borrower may have a number of days' grace to remedy the default before enforcement action may be taken by the lender.

The lender's security documents will often contain detailed enforcement provisions setting out the steps the lender is entitled to take following an event of default, for example, dating the signed stock transfer form provided collateral to a share charge to transfer ownership of the shares in the borrower away from its parent, or (though infrequent in shipping transactions) by appointing a receiver in respect of the charged assets. If the borrower or other obligor disputes the lender's enforcement action (eg, a guarantor refuses to pay overdue amounts that the borrower has failed to pay), the lender will need to enforce its rights either through the English courts, or if the borrower or other obligor is insolvent and unable to pay, as a secured creditor in the relevant insolvency regime to which the borrower or other obligor is subject (see question 41).

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

Security over shares is common in ship finance transactions as the borrower will often be a limited liability company or special purpose vehicle with no assets other than the ship itself. Under a share pledge or charge, all of the shares in the borrower are charged or pledged to the lender, who, following a default by the borrower under the loan, will be able to step in and take ownership of the borrowing company or, alternatively, sell the shares to a third party. This gives the lender the ability to sell the shipowning company, as well as the ship itself.

The share security will either be in the form of a 'share pledge' or a 'share charge'. The form will be dependent on whether the shares are bearer shares or registered shares. (See question 32.)

A share pledge depends upon physical possession of the share certificates. In order to perfect its security, the lender will want possession of all of the share certificates of the issued shares of the borrowing company.

A share charge does not legally depend on the bank having physical possession of the share certificates. However, in the event that the borrower defaults and the lender wishes to sell the shares, the lender will need the share certificates and executed stock transfer forms in order to perfect its security. Therefore, as an ancillary to the share charge, the lender will require the borrower to execute undated stock transfer forms, which, following an event of default by the borrower, the lender will then complete in favour of itself or, more likely, a new arm's-length shareholder.

For both a share pledge and a share charge, the lender will also require undated letters of resignation from each of the directors of the borrowing company to enable the lender to replace the directors and officers of the company with its own team in the event of default by the borrower. Irrevocable proxies and directors' undertakings may also be obtained.

In the UK, the share pledge or charge should be registered at Companies House against the shareholding company.

36 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?

It is an established principle of English corporate law that a shareholder of an English company is only liable for the company's debts up to the value

of its shareholding. English courts strictly adhere to the corporate veil principle (whereby a company is recognised as a legal person separate from its shareholders), and will only pierce the veil and look to the members in exceptional circumstances where a number of conditions are met and there is proven impropriety.

Before and after the exercise of share security granted in its favour, a lender will, however, need to be aware of the English statutory concept of 'shadow director' set out in section 251 of the Companies Act 2006, whereby persons (excluding professional advisors) in accordance with whose directions or instructions the directors of the company are accustomed, will be treated as directors and, therefore, be subject to the same legal duties where and to the extent those duties are capable of applying and may be liable in the same way if illegality is proven, such as fraud or misconduct in the winding-up of the company in contravention of the Insolvency Act 1986. The Insolvency Act also treats shadow directors as 'connected' to the company and provides liquidators or administrators with significant power to challenge transactions involving shadow directors prior to the onset of insolvency as a preference or at an under value. It should, however, be noted that, to date, a lender has not been proven in the English courts to be acting as a shadow director.

Tax considerations for vessel owners

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

The mere registration of a vessel in the UK will not cause the income from operation of the vessel to become subject to UK tax. As indicated in question 7, a company is subject to UK corporation tax if it is a UK tax resident or if it is non-resident but carries on a trade through a UK permanent establishment. A ship is not treated as a permanent establishment for this purpose.

The current rate of UK corporation tax payable on taxable profits is 20 per cent.

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

In addition to the standard corporation tax rules in the UK, there is a separate tonnage tax regime into which companies operating qualifying ships that are strategically and commercially managed in the UK can elect. Those who elect into the regime pay tax based on the net tonnage of the ships operated rather than by reference to the profits earned from such operations. The result is a very low effective rate of tax. An election into the tonnage tax regime has a minimum duration of 10 years.

In order to qualify for tonnage tax the following criteria must be satisfied:

- the company must be within the charge to UK corporation tax, namely, tax resident in the UK or carrying on business through a permanent establishment in the UK (see question 7);
- the company must 'operate ships'. This means it must own or charter out the ship. It is the operator of a ship that is eligible for tonnage tax, so the owner of a ship will generally not be eligible if it charters the ship on bareboat terms;
- the ships must be 'qualifying ships'. This means they must be 100 GT or more, be seagoing and be used for a 'core qualifying activity'. These activities are: carriage of passengers or cargo by sea; towage, salvage or other marine assistance carried out at sea; and transport by sea in connection with other services necessarily provided at sea;
- qualifying ships must be strategically and commercially managed in the UK. Strategic and commercial management will be assessed by reference to certain specific criteria; and
- the company must not time charter in on average more than 75 per cent of its net tonnage.

Companies electing to enter and remain within the tonnage tax regime must commit to providing officer-training places in proportion to the number of officers employed by the company on its qualifying ships.

Tonnage tax-related losses cannot be used to reduce other profits liable to corporation tax. Tonnage tax companies are also not permitted to deduct loan financing interest from other taxable profits or to claim capital allowances (tax depreciation) in respect of vessels within the tonnage tax regime.

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

There are no special tax incentives for shipowners registering vessels in the UK. The tonnage tax regime (see question 38) does not require that the vessels be registered in the UK.

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

Taxable profits generated by shipping activities outside of the tonnage tax regime (see question 38) are subject to UK corporation tax in the usual way.

The rate of capital allowances (tax depreciations) on ships has now reduced to 8 per cent. This is partly responsible for a reduction in previously popular tax leasing products provided by ship financiers, where the financier would lease the ship to the customer and use accelerated tax depreciation to reduce the financing costs.

Insolvency and restructuring

41 Is there a general scheme of reorganisation or insolvency administration in your jurisdiction?

There is a general scheme of restructuring and insolvency administration in the UK. It is the process of administration governed by Schedule B1 to the Insolvency Act 1986. Under these rules the administration of a company must achieve one of the following objectives (in order of priority):

- the rescue of the company (the primary objective);
- the achievement of a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration) (the second objective); or
- the realisation of some or all of the company's property to make a distribution to one or more secured or preferential creditors (the third objective).

If a ship mortgagor is subject to insolvency proceedings, all legal proceedings against the mortgagor will be stayed by virtue of an automatic moratorium. However, the mortgagee is still free to enforce its security and retain the proceeds of enforcement in priority to unsecured creditors, provided that the mortgagee does not require the assistance of the courts for such enforcement.

On the other hand, if the ship mortgagor is in the process of administration, a moratorium is created (paragraphs 42 and 43, Schedule B1, Insolvency Act 1986) during which no legal proceedings, or enforcement of security can take place without the consent of the administrator or the court. This moratorium does not alter the substantive rights of any party against a company in administration, but simply suspends the exercise of those rights during the administration. This does not prevent creditors from terminating contracts or from exercising rights of set-off.

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

The general English common law principle is that a foreign judgment will be enforceable in England and Wales if the defendant was

- present in the foreign country;
- submitted to the jurisdiction of that court by voluntarily appearing in proceedings; or
- (before the commencement of the proceedings) the defendant had agreed, in respect of the subject matter of the proceedings, to submit to the jurisdiction of that country.

Therefore, at common law, if a defendant was not present in the jurisdiction of the foreign court and did not submit to that jurisdiction, he or she can generally expect that judgment will not be enforceable against him or her in England and Wales.

However, the English common law position has been modified by various statutes, case law and EU regulation.

The EC Brussels I Regulation (applicable to cases commenced before 10 January 2015) and the Recast Brussels Regulation (for cases commenced from 10 January 2015) states that it is not a defence to recognition of a judgment that the defendant did not submit to the jurisdiction. However, these regulations expressly do not apply to bankruptcy or insolvency proceedings so will not be considered further here.

The EC Regulation on Insolvency Proceedings allocates jurisdiction to the courts of the country in which the insolvent company has its centre of

main interests (usually its head office or the place where the majority of its business was conducted). It then provides for automatic recognition of the effects of that insolvency in all member states.

The UNCITRAL Model Law on Cross-Border Insolvency, which has been implemented in English law by the Cross-Border Insolvency Regulations 2006, similarly provides for recognition by the English courts of foreign insolvency proceedings brought in the courts of the debtor's centre of main interests. To date, only some 20 countries have adopted the Model Law.

The Foreign Judgments (Reciprocal Enforcement) Act 1933 provides for the recognition of judgments from specified jurisdictions, provided those judgments are registered.

In the recent Supreme Court joined appeals of *Rubin v Eurofinance SA* and *New Cap Reinsurance Corporation v AE Grant*, the issue facing the court was whether the jurisdiction of the English court to assist a foreign insolvency proceedings extended to recognition of foreign judgments that would not otherwise be entitled to recognition due to the lack of submission to the jurisdiction by the defendant.

The Supreme Court held that it would not recognise the judgment of a foreign court unless the defendant was present in or had submitted to its jurisdiction. It made it clear that judgments of courts in foreign insolvency proceedings are not to be accorded special status.

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

The order of priority among creditors in the UK is as follows:

- proceeds of fixed-charge assets (less direct realisation costs) to fixed charge-holders;
- fees and expenses of the liquidator or administrator;
- preferential debts paid to preferred creditors – usually limited to employee wages;
- the 'prescribed part' set aside from realisations from floating charge assets for unsecured creditors (up to a maximum of £600,000);
- proceeds of floating charge assets (less preferential debts and the prescribed part) paid to floating charge-holders;
- unsecured creditors (including the tax authorities) – rank equally between themselves unless they are subject to a binding subordination agreement;
- interest incurred on all unsecured debts post-liquidation; and
- any surplus paid to shareholders in accordance with the company's articles of association.

A creditor may be required to disgorge payments from an insolvent company where:

- the insolvent company is found to have granted a preference, which occurs where:
 - within six months (or two years if the person being preferred is connected with the company) before the company went into liquidation, the insolvent company took an action that has placed a creditor in a better position than he or she would have been in;
 - the company was influenced by the desire to prefer that creditor; and
 - at the time of the action, the company was unable to pay its debts; or
- the insolvent company is found to have made a transaction at an undervalue. This is where within two years before the administration or liquidation, a transaction was made with a person connected to the company, at below the market value, and at the time of the transaction the company was unable to pay its debts as they fell due.

In either case, an administrator or liquidator may apply to the court for an order avoiding any such action or transaction at undervalue and the creditor may be forced to give back any profit he or she has made as a result.

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

Generally, under English law, a shipowner may provide security on behalf of other related or unrelated companies. In relation to public companies (and private companies with a public parent company), there may be issues regarding the giving of financial assistance that is prohibited under the Companies Act 2006.

Update and trends

Although the end of 2014 to the start of 2015 has seen the partial return of some shipping banks, notwithstanding private equity becoming a key player in the provision of capital within shipping, we are still experiencing a shortfall in available finance. We are witnessing a critical time for the industry as there is a need for investment in the technology and services necessary to achieve compliance with stricter environment regulation and improve commercial performance. With freight rates falling across most sectors, there is a need to cut costs and improve efficiency. In 2014, the world fleet grew by 3.39 per cent, but total ship finance bank debt still continued to fall. We have also seen the continued divestment of shipping assets, particularly among Greek shipping banks, and expect shipping portfolios at many Greek, German and UK banks to continue to be run off. This has led to many owners seeking to access the capital and bond markets, the continued emergence of private equity funds to fill the gap and a sustained shift of ship finance eastwards, which we expect to continue in 2015.

In order for the security to be enforceable, the security must be duly executed and the party taking the security should be advised to conduct due diligence as to the relevant corporate authorities of the shipowner providing the security.

45 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?

Under English law, when a company has entered into insolvency proceedings, certain transactions that were entered into by the company before the insolvency began may be challenged by an administrator or liquidator under the Insolvency Act 1986. These transactions are known as 'reviewable transactions'.

The types of reviewable transaction or grounds on which a transaction may be challenged under the Insolvency Act 1986 are as follows (in the case of (i) and (ii), see question 43, and if the criteria in (i), (ii) and (iii) are satisfied, the floating charge will automatically be invalid and no application needs to be made by the office holder):

- (i) if the insolvent company has granted a preference (section 239);
- (ii) if the insolvent company is found to have made a transaction at an undervalue (section 238);
- (iii) if the insolvent company benefits a creditor by granting a floating charge for existing debt for no new consideration (section 245). A floating charge may be avoided where:
 - it has been created in the 12 months (or in two years if in favour of a person connected with the company) before a company's insolvency to secure past indebtedness (eg, if a floating charge is granted by the company to secure a loan to the company that was previously unsecured);

- it was given as a preference to a creditor or if it was given in exchange for prior consideration;
 - at the time the floating charge was created, the company was unable to pay its debts or became unable to pay its debts as a consequence of the charge; and
- (iv) if the company entered into a transaction defrauding creditors (section 423). A transaction may be set aside where:
- the transaction was entered into at an undervalue; and
 - the purpose was to put assets beyond the reach of a creditor or a person who is making a claim or make a claim against the company.

There is no requirement for the company to be insolvent, in liquidation or in administration in order to make a challenge under section 245.

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

Compulsory liquidation is a court-based procedure whereby assets of a company are realised and distributed to the company's creditors and shareholders before the company is dissolved. The circumstances in which a company may be wound up are set out in section 122(1) of the Insolvency Act 1986.

A creditor wishing to wind up a company should first conduct a search to ensure that no winding-up petition is already pending, search the register at Companies House to check whether the company is already in some insolvency procedure and check with the Companies Court to check whether there are any other winding-up petitions.

Winding-up petitions are usually made in the High Court (in the Companies Court in London or a district registry if outside London). In order to compel liquidation, the creditor (who will be the 'petitioner') must be able to prove to a court that the company is unable to pay its debts as they fall due. Methods include:

- if a creditor (by assignment or otherwise) to whom the company owes a sum of £750 or more has served a statutory demand that has not been paid within three weeks;
- if a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part;
- if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due; or
- if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

The petitioner, once able to prove the company is insolvent, must then prepare, file at court and serve on the company the petition for winding-up.

At the hearing of the winding-up petition, the judge may: dismiss the application; adjourn the hearing; make a winding-up order; make an interim order; or make any other order as it thinks fit. When exercising his or her or her discretion, the judge will have regard to the wishes of the creditors.

holman fenwick willan **hfw**

Tony Rice
Ian Hughes

tony.rice@hfw.com
ian.hughes@hfw.com

Friary Court
65 Crutched Friars
London EC3N 2AE
United Kingdom

Tel: +44 20 7264 8000
Fax: +44 20 7264 8888
www.hfw.com

Once a winding-up order is made, the official receiver becomes the liquidator and upon the making of a winding-up order the liquidator takes control of the company's assets.

47 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 Model Netting Act has not been adopted into English law. However, English law has a statutory regime set out in Part VII of the Companies Act

1989 whereby the operation of certain (otherwise conflicting) provisions of the Insolvency Act 1986 are amended in order to protect the financial markets from the insolvency of market participants. The regime is complex, however, the general effect for institutions acting as swap providers is that if an institution closes out the contracts of a defaulting party, the gains and losses on those contracts are netted out and thereby either reduced to a net gain payable to the defaulter or a net loss provable in their insolvency.

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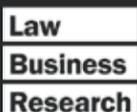
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ISSN 2056-4015



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