

# **FLAG STATE COMFORT FOR THE SECURED LENDER IN THE DIGITAL AGE\***

Remarks delivered at  
A Joint Meeting of

**The Maritime Law Association Of The  
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I am aware that the International Working Group has been given the mission of “understanding how ship finance interests are currently protected and secured”.

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\*The comments that follow are my own, and do not constitute statements of policy, or official pronouncements, by the ship and corporate registry of the Republic of the Marshall Islands, or of International Registries, Inc. or its affiliates.

Very helpfully, if worryingly, Ann sent me an email reading in part as follows:

“Your talk as a representative of an important Flag State is important and we would like to hear what level of protection the law of the Marshall Islands gives to financiers and mortgagees as an example. It will be important to see how the flag protects the mortgagee in practice, how interests and mortgages are registered, what happens in case of default, what rights does the mortgagee have etc. The idea is to use the Marshall Islands as an example of a big established and popular register. Of course please feel free to speak generally as well as in terms of how you feel the mortgagees rights of security are currently protected – or not – by most of the most popular flags”.

The process, procedure and legal requirements for registering a ship, and recording a ship mortgage, and related instruments, is primarily governed by the law of the state of registry (“the flag state”).

The mortgage, after all, gets recorded in the flag state, so it stands to reason that the ingredients and scope of the mortgage and related instruments will also be subject to the flag state's law.

Of course, the word "protected" is perhaps a relative one. My answer is that the "protection" is in the form of statutory provisions, largely in Sections 301-322 of the Maritime Act.

The strength of those provisions lies in the fact that the remedies permitted to the lender are considerably broader, under the statute, than those of most other registries.

There are several levels of "comfort", in which flag state law plays a significant part:

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1. The flag state's legal and procedural framework governing the documents validating the registration and

recordation process, usually in the form of certificates provided by the flag state to the parties, see, for example, Section 303 and 307 of the MI Act;

2. The scope allowed to mortgages, loan agreements and similar documents, described in several sections of the MI Act, including Section 303.
3. The security and effectiveness of the Oracle system of registration and recordation;

About two thirds of the world's fleet is now registered with the eight largest open registries, which are, in order of size, Panama, Liberia, Marshall Islands, Hong Kong and Singapore. They aggregate something like 22,000 ships. There were, at the end of March, some 3,788 vessels registered in the Marshall Islands, with a gross tonnage of 131,125,513.

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Most major flag states have, over the years, modernized, by means of statute, the three basic criteria listed above. That said:

Not all old law is bad law;  
Some old law is good law;  
Some old principles – many, in fact – are good principles;

But, much has changed in the world of ship finance, and, indeed, in shipping itself, since the days when the Foreign Preferred Ship Mortgage was last amended.

Some ancient rituals have become obsolete.

Some are onerous.

Many flag state administrations have failed to consult with the lawyers who must apply these principles.

Starting in 1992, the Marshall Islands embarked on a system of registration and recordation, made available at multiple locations, such as Greece, London, Hong Kong and Singapore, as well as New York.

We were aware that, in addition to being compatible with modern digital technology, the system had to effectively lock in lien priorities, and be open to public inspection.

In this, we took the advice of a team of experts, which became the Marshall Islands Legal Roundtable.

The complex “ballet” of recordation, registration, and release of documents, as well as funds, required a great deal of thought, as well as some trial and error.

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The Marshall Islands employs a “mortgage screen”, part of an Oracle program, developed over time. Essentially, once an instrument is

recorded, the data internally cannot be modified except pursuant to amendment. The mortgage screen is contained within a larger vessel screen, and when the data is entered from the Memorandum of Particulars, supplied by counsel, it is checked against the actual provisions of the mortgage.

The traditional language of mortgage recordation legislation, and international conventions, contained such wording as: “registered under those laws in a public register at the port of registry of the vessel or at a central office”.

Our group of experts, led by the late Emery Harper, concluded that the language of the U.S. Foreign Preferred Ship Mortgage Act did not require that the instruments actually be filed at a registry office, but only that they be “registered” in a public registry at a central office.

The key section reads:

“Preferred Mortgage” –



... means in Sections 31325 and 31326 of this title, a mortgage, hypothecation, or similar charge that is established as a security on a foreign vessel if the mortgage, hypothecation, or similar charge was executed under the laws of the foreign country under whose laws the ownership of the vessel is documented and has been registered under those laws in a public register at the port of registry of the vessel or at a central office. [Emphasis added]

The Maritime Act contains provisions protecting the Preferred Mortgage lien (Sections 311 & 313 (2)).

As I have said, our digital program had to support the issuance of documents, such as Certificates of Ownership and Encumbrance, the famous “blue backs”, and Certified Extracts



of the Mortgage Index Page, as formal “evidence of recordation of a Preferred Ship Mortgage under this Chapter” (Section 307 of the MI Act);

Lawyers in London, Greece, Norway, New York and Tokyo made a number of suggestions to modernize and adapt what is now Chapter 3, notably Sections 302-313 of the MI Act.

You may recall that, for example, it was a rule in the United States, and therefore under Liberian and Marshall Islands law, that a ship mortgage could only be “made”, that is, signed and acknowledged, at the closing itself;

The effect of this kind of procedural taboo was to make registrations burdensome and, in terms of legal fees and other charges, costly;

The problem illustrated above was solved by the insertion of two words: “whenever made”, in what is now Sections 303 (1) and

307 of the MI Act. So now, a Marshall Islands mortgage could be signed and acknowledged in advance of the closing, “in the comfort of your own home or office”, so to speak.

A few interesting ingredients now in the MI Act include provisions on:

1. Financing charters, i.e., a contract or charter party giving a security interest in a vessel in favor of a documented owner (Section 302A);
2. Registration and mortgage finance of vessels under construction (Sections 112 (3); 203 (f); 303 (1); and 309 (2)(b)(i));
3. A statutory section specifying that a Marshall Islands mortgage could explicitly secure miscellaneous fees, pledges, assignments, charter hire, freight revenues, etc. (Section 303);

4. A Marshall Islands Preferred Ship Mortgage may cover, within its scope, property that is not a vessel (Section 308), largely influenced by existing Japanese and Korean law, without the requirement of separate discharge;
5. Elimination of the former requirement of a “commitment to lend” on the part of the mortgagee; allowing the securing of future and contingent as well as present transactions (Section 303 (1));
6. Inclusion of a provision allowing multiple currencies (Section 310 of the MI Act);
7. Permitting future advances, including the maximum amount that may be outstanding, or the aggregate of all possible advances (Section 309 (1));

8. So-called “continuation mortgages”, protecting a previously recorded mortgage or similar charge granted under the laws of another flag state, particularly where a vessel has thereafter left a foreign flag, and been registered in the Marshall Islands (Section 303 (2));
9. This so-called “continuation mortgage”, protects, for a period of time, the preferred status of a foreign mortgage, following registration of the vessel in the Marshall Islands, even where the mortgage recorded in the foreign flag has been previously released, as a condition for the deletion of the ship from that prior register (Section 303 (2));
10. Protection of the mortgage lien, even if the mortgage itself does not provide for the separate discharge of

property “other than the vessel”  
(Section 309(2));

11. There is a sweeping provision in the MI Act preserving the interests of a mortgagee, and preventing its termination, even where the vessel was cancelled from the Marshall Islands registry, or (the vessel) has been lost, destroyed or transferred to another registry (Section 304);
12. The ranking and priority of liens – always a topic of interest – follows the non-statutory and legislative principles laid down in the United States, with certain improvements. Under Sections 318 and 319, the order of priorities are: under Section 318, of the MI Act are, tort liability; unpaid tonnage taxes and registry fees and charges; wages of the crew; including the master; general average; salvage; court costs, the

preferred mortgage lien; necessities and non-lien claims; social security and tax claims. You will note that some of these are not true maritime liens. There is always the possibility of debate as to whether the existence, validity and/or priority of a lien should be decided under the law of the place where it allegedly arose; or the law of the forum; or the law of the flag state.

13. The lien of a Marshall Islands preferred mortgage may be enforced, of course, in any court of appropriate jurisdiction, including by a suit in rem in the High Court of the Marshall Islands (Section 316).

The above is a very brief summary. There is, in the words of late-night television commercials, “much, much more”. Digital technology has made it possible to take the registry office to where

the customer is likely to be, rather than make that customer beat a path to the one office, somewhere in the world, where the ship and its financing documents can be registered. Service at the point of purchase is now a reality.

Joining me today are John Ramage and Emily Richmond, who have considerable experience in applying the procedures and technology referred to above. I urge you to say hello to them, and seek further answers.

Once again, thank you, Marjorie and Ann, and Frank, and many others, for your assistance today and over the years.

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