

CURRENT DEVELOPMENTS IN MARINE FINANCING  
FINANCING THE FISHING INDUSTRY

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Stephen B. Johnson  
Bruce A. King

Garvey Schubert Barer

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In recent years there have been two major developments in the fishing industry that affect lending transactions. One involves recent legislation to further restrict the involvement of non-citizens in the fishing industry -- both non-citizen investors in fishing companies and noncitizen lenders. The American Fisheries Act of 1998 (“AFA”),<sup>2</sup> the “lender amendments” to the AFA adopted by Congress in 2001,<sup>3</sup> and the regulatory implementation of this legislation by the Maritime Administration and the Coast Guard have significant implications for lenders. The second major development affecting lenders stems from the continuing movement in some major fisheries away from open access or “Olympic” style fisheries to limited entry systems. These developments, both of which remain moving targets, must be taken into account by lenders in their credit decisions and in documenting their transactions and perfecting their security.

**Lenders and the American Fisheries Act.**

The American Fisheries Act made major changes in the federal laws governing (1) the eligibility of vessels and vessel owners to engage in the U.S. fisheries and (2) the eligibility of lenders to hold preferred mortgages on fishing industry vessels 100 ft. or greater in registered length.<sup>4</sup> Most of the AFA’s provisions affecting vessel owners went into effect on October 1, 2001; the provisions most directly affecting lenders became effective on April 1, 2003. Final MARAD regulations implementing the provisions of the AFA regulating lenders were published on February 4, 2003.<sup>5</sup>

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<sup>1</sup> Steve Johnson and Bruce King are principals in the Seattle office of Garvey Schubert Barer and members of its Maritime Business & Finance Group.

<sup>2</sup> Pub.L. 105-277, Division C, Title II (Oct. 21, 1998), 112 Stat. 2681-616.

<sup>3</sup> Pub.L. 107-20, Title II, §2202 (July 24, 2001), 115 Stat. 168.

<sup>4</sup> Although the AFA also contained important measures limiting entry into the Alaska pollock fishery and providing for the purchase and scrapping of a number of vessels in that fishery, the present discussion focuses on the changes made by the AFA to the vessel documentation and the ship mortgage statutes.

<sup>5</sup> 68 Fed. Reg. 5564 *et seq.* (Feb. 4, 2003).

### *New U.S. Citizenship Test for Fishing Vessel Owners*

For fishing vessel owners, the AFA prescribed a new U.S. citizenship test: 75% U.S. citizen *ownership* and U.S. citizen *control*. Where a vessel is owned by an entity that, in turn, is owned by other entities, the 75 percent U.S. citizen ownership requirement is applicable “at each tier of ownership and in the aggregate.”<sup>6</sup> The aggregate U.S. citizen ownership requirements of the AFA are stricter than the citizenship test applicable to the U.S. coastwise trade. The AFA’s general requirement of U.S. citizen “control” was supplemented by specific prohibitions in the AFA (such as the new prohibitions against bareboat charters to non-citizens of all fishing industry vessels<sup>7</sup> and time charters to non-citizens of vessels engaged in harvesting activities<sup>8</sup>) and a charge to the Maritime Administration (“MARAD”) to carefully scrutinize contractual arrangements -- including financing arrangements -- between vessel owners and non-citizens and to issue rules defining and prohibiting contractual arrangements deemed to involve an impermissible degree of non-citizen control.<sup>9</sup> The AFA’s new U.S. citizen ownership and control requirements went into effect on October 1, 2001.

### *New U.S. Citizenship Test for Mortgagees*

The AFA prescribed a separate U.S. citizenship test for lenders permitted to hold preferred mortgages on fishing industry vessels 100 ft. or greater in registered length. As originally adopted in 1998, the AFA limited eligible lenders to entities that either satisfied the AFA’s new citizenship standard for fishing vessel owners *or* were state or federally chartered financial institutions able to demonstrate majority U.S. citizen ownership.<sup>10</sup>

However, three major problems with these limitations quickly became apparent. First, major publicly traded U.S. banks discovered that demonstrating majority U.S. citizen ownership would be cumbersome and expensive at best and in some cases impossible. Non-bank commercial finance companies -- often the subsidiaries of public companies -- had even greater problems demonstrating qualification under the AFA’s 75 percent U.S. citizen ownership test. Second, although the AFA provided that non-citizen lenders could hold mortgages through mortgage trustees in very limited circumstances, the restrictions imposed on such arrangements, including prior MARAD review and approval of all loan documents, were so onerous that this option was deemed impractical for most purposes. Finally, the restrictions on lenders were linked with the vessel documentation provisions of the AFA in a way that left vessel owners and lenders uncertain whether their financing arrangements might jeopardize the vessel owner’s eligibility for a fishery endorsement if the lender failed to satisfy the AFA’s restrictions.

Because of the problems identified with the AFA’s original lender provisions, Congress enacted amendments to the AFA in July 2001.<sup>11</sup> These “lender amendments” postponed the

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<sup>6</sup> 46 U.S.C. §12102(c)(1).

<sup>7</sup> 46 U.S.C. §12102(c)(2)(A)(iii).

<sup>8</sup> 46 U.S.C. §12102(c)(3).

<sup>9</sup> AFA §203(b), (c) (reproduced in notes following 46 U.S.C.A. §12102).

<sup>10</sup> AFA §202(b).

<sup>11</sup> *See* footnote 3 above.

effective date of the AFA's lender provisions until April 1, 2003 and made major changes in those provisions. Several new classes of lenders were defined that may hold preferred mortgages without demonstrating the citizenship of their shareholders. These include FDIC insured financial institutions, farm credit lenders, commercial fishing and agriculture banks and certain qualified "commercial lenders."<sup>12</sup>

What is a qualified commercial lender? There is a two part test designed to make sure that only *bona fide* U.S. financial institutions will qualify to hold mortgages directly: First, the "lender amendments" define a "commercial lender" as "an entity primarily engaged in the business of lending and other financing transactions with a loan portfolio in excess of \$100,000,000, of which not more than 50 per centum in dollar amount consists of loans to borrowers in the commercial fishing industry, as certified to the Secretary by such lender."<sup>13</sup> Second, to be eligible to hold a preferred mortgage directly, a commercial lender must also be eligible to document a vessel under 46 U.S.C. 12102(a).<sup>14</sup> This second requirement means that a corporate lender must be incorporated in the United States, must have U.S. citizens serving as president, CEO and chairman of the board of directors, and no more of the corporation's directors may be non-citizens than a minority of the number necessary to constitute a quorum. These criteria are relatively easy to satisfy, but in an age of global capital markets and cross-border mergers and acquisitions, lenders will need to take care in executive appointments in entities that extend credit to the fishing industry.

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<sup>12</sup> While the 2001 lender amendments liberalized the mortgagee eligibility rules, the AFA as amended does not allow a Non-Citizen lender to own and document a fishing industry vessel. When the sale of a vessel to a Non-Citizen lender at a Marshal's auction is confirmed, the vessel's documentation, including its fishery endorsement, normally becomes invalid. 46 C.F.R. 67.167(b)(1). For large vessels, this poses a potential problem. Section 202(a)(6)(A)(iii) of the AFA, 46 U.S.C. §12102(c)(5)(A)(iii), provides that a vessel greater than 165 feet in registered length, of more than 750 gross registered tons, or that has an engine or engines capable of producing more than 3,000 shaft horsepower is not eligible for a fishery endorsement "unless, in the event of invalidation of the fishery endorsement after [October 21, 1998], application is made for a new fishery endorsement within fifteen (15) business days of such invalidation." Thus, if a lender eligible to hold a mortgage but not eligible to own and document a fishing industry vessel purchases one of these larger vessels at a Marshal's sale, there would seem to be a fifteen day window after confirmation of the sale within which the lender must transfer title to a qualified Citizen purchaser and the purchaser must apply for Coast Guard documentation with a fisheries endorsement. Failure of the new owner to re-apply for a fishery endorsement within this fifteen day period could at least arguably cause the vessel to become permanently ineligible for a fishery endorsement. Arranging such a purchase and transfer without collusive bidding would take some careful planning, failing which the Non-Citizen lender would need to avoid a credit purchase of the vessel. MARAD has attempted to provide a regulatory solution to this dilemma in 46 C.F.R. §356.47(b)(3), which provides in pertinent part: "The fishery endorsement of a Fishing Industry Vessel that meets the criteria of [46 U.S.C. §12102(c)(5)] is not deemed to be invalid . . . , if the vessel is purchased pursuant to 46 U.S.C. 31329 by a Mortgagee that is not eligible to own a vessel with a fishery endorsement, provided that the Mortgagee is eligible to hold a preferred mortgage on such vessel at the time of the purchase."

<sup>13</sup> 46 U.S.C. §31322(g).

<sup>14</sup> 46 U.S.C. §31322(a)(4)(E).

### *New Requirements Applicable to Mortgage Trust Arrangements*

For lenders that are not eligible to hold preferred mortgages directly under the AFA's new mortgagee eligibility standards, the AFA revived the use of mortgage trustees to hold ship mortgages -- the so-called "Westhampton" trustee. The 2001 lender amendments to the AFA relaxed the restrictions on mortgage trust arrangements and expanded the category of eligible mortgage trustees to include any FDIC insured financial institution with corporate trust powers and a combined capital and surplus of at least \$3,000,000.<sup>15</sup> The lender amendments specified that prior MARAD review and approval of loan documents would only be required where the beneficiary of the trust arrangement was *not* a "commercial lender" or a "lender syndicate."<sup>16</sup> Thus, a non-citizen commercial lender, such as a foreign bank, or a "lender syndicate" with non-citizen participants, could hold a preferred mortgage on fishing industry vessels 100 ft. or greater in length through a qualified mortgage trustee without prior MARAD approval of the loan documents (or amendments to those documents).

For this purpose, a "lender syndicate" is now defined as "an arrangement established for the combined extension of credit of not less than \$20,000,000 made up of four or more entities that each have a beneficial interest, held through an agent, under a trust arrangement . . . , no one of which may exercise powers thereunder without the concurrence of at least one other unaffiliated beneficiary."<sup>17</sup>

As of April 1, 2003, a lender that is not qualified to hold a mortgage directly and is not a "commercial lender" or a participant in a "lender syndicate," as now defined in the ship mortgage statute, may hold a preferred mortgage through a mortgage trustee only if MARAD reviews and approves the loan documents.

### *The MARAD Regime*

Congress assigned administrative responsibility for implementing the provisions of the AFA applicable to fishing industry vessels 100 ft. or greater in length, including the provisions amending the ship mortgage statute, to MARAD. On February 4, 2003, MARAD published final rules to implement the requirements of the AFA, as amended, applicable to lenders. The AFA's lender provisions and MARAD's implementing rules implementing those provisions became effective on April 1, 2003.

The new MARAD rules require *all lenders, regardless of citizenship*, holding preferred mortgages on affected vessels to take affirmative steps to meet the requirements of the new rules.

**Lenders Eligible to Hold Preferred Mortgages ("Eligible Mortgagees") Under the New Rules.** On and after April 1, 2003, only the following persons are eligible to hold preferred mortgages on fishing industry vessels 100 ft. or greater in registered length:

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<sup>15</sup> 46 U.S.C. §31322(f)(1).

<sup>16</sup> 46 U.S.C. §31322(f)(2).

<sup>17</sup> 46 U.S.C. §31322(h).

(1) A “fisheries citizen;” i.e., a person eligible to own a vessel with a fishery endorsement;<sup>18</sup>

(2) A state or federally chartered financial institution that is insured by the Federal Deposit Insurance Corporation;

(3) A farm credit lender established under title 12, chapter 23, of the United States Code [12 U.S.C. §2001 *et seq.*];

(4) A commercial fishing and agriculture bank established pursuant to state law;

(5) A “Commercial Lender”<sup>19</sup> organized under the laws of the United States or of a State and eligible to own a vessel under 46 U.S.C. §12102(a);<sup>20</sup> or

(6) A mortgage trustee that complies with the requirements of 46 U.S.C. 31322(f) and 46 C.F.R. 356.27 through 356.37.

*See* 46 U.S.C. 31322(a)(4); 46 C.F.R. 356.19(a).

**Requirements Applicable to Eligible Mortgagees:** All eligible mortgagees must submit proof of their eligibility to hold a preferred mortgage to MARAD under the new rules. For preferred mortgages in existence prior to April 1, 2003, the mortgagee must make this demonstration to MARAD prior to the vessel’s next certificate of documentation renewal date *after* April 1, 2003. *Lenders holding preferred mortgages on several vessels prior to April 1, 2003 should make the required filings with MARAD prior to the first certificate of documentation renewal date for any vessel on which they hold a preferred mortgage.* In all events, the required filings with MARAD must be made before a lender closes a new preferred mortgage transaction on or after April 1, 2003. 46 C.F.R. 356.19(b).

**Requirements Applicable to Persons Ineligible to Hold Preferred Mortgages:** On and after April 1, 2003, unless grandfathered under the treaty exemption provided by §213(g) of the AFA,<sup>21</sup> a person that is not eligible to hold a preferred mortgage directly may only hold a

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<sup>18</sup> For this purpose, an entity must meet the AFA’s 75% U.S. Citizen ownership requirement “at each tier of ownership and in the aggregate.” *See* 46 U.S.C. §12102(c).

<sup>19</sup> A “Commercial Lender” is “an entity that is primarily engaged in the business of lending and other financing transactions with a loan portfolio in excess of \$100,000,000, of which not more than 50 per centum in dollar amount consists of loans to borrowers in the commercial fishing industry, as certified to the Secretary by such lender.” 46 U.S.C. §31322(g). *See also*, 46 C.F.R. 356.3(g).

<sup>20</sup> To satisfy this additional requirement, a Commercial Lender must be organized under U.S. law and, if a corporation, its president, CEO and chairman of the board must be U.S. citizens and no more than a minority of a quorum of the board of directors may be non-citizens. *See* 46 U.S.C. §12102(a).

<sup>21</sup> AFA §213(g) permits a mortgagee ineligible to hold a preferred mortgage under the new AFA restrictions to obtain an exemption from those restrictions by petitioning MARAD for a determination that the new requirements of the AFA, as applied to such mortgagee with respect to a preferred mortgage in existence on July 24, 2001, are “inconsistent with an existing international agreement relating to

preferred mortgage through a mortgage trustee approved by MARAD, using a “Westhampton trust” arrangement. In order to preserve the preferred status of their mortgages, mortgagees no longer eligible to hold their preferred mortgages directly under the new restrictions were required to assign their mortgages and related debt instruments to a mortgage trustee approved by MARAD. 46 C.F.R. 356.27(a).<sup>22</sup>

A mortgage trustee holding a preferred mortgage in trust for a person ineligible to hold a preferred mortgage, other than a Commercial Lender or a member of a “Lender Syndicate,”<sup>23</sup> must also submit the trust agreement and loan documents to MARAD so that a determination can be made whether any of the arrangements results in an impermissible transfer of control of the vessel to a person not eligible to own a vessel with a fishery endorsement. 46 C.F.R. 356.19(b)(6). MARAD review of mortgage trust agreements and loan documents is not generally required if the beneficiary under the trust arrangement is a Commercial Lender or a member of a Lender Syndicate.<sup>24</sup>

A fish processing company or fish buyer, for example, that is not itself eligible to document fishing vessels must use a mortgage trustee and have its financing documents reviewed by MARAD, if it makes loans secured by a borrower’s fishing vessel. The statutory requirement that MARAD “must determine” that the financing arrangement “does not result in an impermissible transfer of control of the vessel” to someone not eligible to document a fishing vessel, 46 U.S.C. §31322(f)(2), suggests that if MARAD determines that the financing documents impermissibly transfer control, the security of the mortgage and the documentation status of the vessel itself could be impaired.

**Annual Filing Requirements.** *All preferred mortgagees*, including mortgage trustees, must make annual filings with MARAD in order to maintain their eligibility to hold preferred mortgages while their secured loans are outstanding.<sup>25</sup> Failure to make the required annual renewal filings within 30 calendar days after MARAD mails a delinquency notice to the

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foreign investment to which the United States is a party.” At least one such exemption has been granted. For the text of §213(g), see the notes following 16 U.S.C.A. §1851).

<sup>22</sup> Failure of an ineligible mortgagee to assign its mortgage and the related debt instrument to an approved mortgage trustee prior to April 1, 2003 would presumably cause the mortgage to lose its preferred status. Subsequent assignment to an approved mortgage trustee should cure this defect and allow the mortgage to regain preferred status -- but with uncertain consequences for the mortgage’s priority.

<sup>23</sup> A “Lender Syndicate” is “an arrangement established for the combined extension of credit of not less than \$20,000,000 made up of four or more entities that each have a beneficial interest, held through an agent under a trust arrangement established pursuant to [46 U.S.C. §31322(f)] no one of which may exercise powers thereunder without the concurrence of at least one other unaffiliated beneficiary.” 46 U.S.C. §31322(h). *See also*, 46 C.F.R. 356.3(n).

<sup>24</sup> If the members of a Lender Syndicate are “engaged in the fishing industry and have contractual relationships with the vessel owner, such as to purchase, process or market the vessel’s catch,” MARAD has indicated that it will require submission of the trust agreement and loan documents for review. *See* 68 Fed. Reg. at 5566 (Feb. 4, 2003).

<sup>25</sup> 46 C.F.R. 356.19(b) (required annual filings by eligible mortgagees); 46 C.F.R. 356.31(a) (maintenance of mortgage trustee approval).

mortgagee (or, in the case of mortgage trustees, after publication of a notice of disapproval in the Federal Register) will cause the mortgage to forfeit its preferred status.<sup>26</sup>

**Loan Syndicates.** Generally, participations in a loan syndicate that qualifies as a “Lender Syndicate” may be freely transferred among participants of any citizenship classification without triggering additional compliance obligations under MARAD’s rules.<sup>27</sup> However, the compliance obligations of loan syndicates that do *not* qualify as Lender Syndicates will depend on the citizenship classifications of the syndicate agent and each participant. Care must be taken to ensure that transfer of a participation in such a loan syndicate does not cause the syndicate to run afoul of MARAD’s rules, thus jeopardizing the security of the syndicate.

MARAD has interpreted its new rules, as applied to loan syndicates, to create one additional trap for the unwary. MARAD has informally indicated to us that a mortgage trustee for a loan syndicate may not also be a participant in the syndicate. Under MARAD’s interpretation, the agent for a loan syndicate that also participates in the syndicate cannot also qualify to act as trustee for the syndicate.

Failure to comply with the requirements of MARAD’s rules will jeopardize the preferred status of the lender’s mortgage. Since, as in the example noted above with respect to loan syndicates, MARAD has made and will continue to make unpublished *ad hoc* decision in interpreting and applying its rules, lenders will need to tread carefully in this area.

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<sup>26</sup> 46 C.F.R. 356.19(c); 46 C.F.R. 356.31(c).

<sup>27</sup> *But see*, footnote 24.



## *Security in Fishing Rights, and Maritime Liens on Fishing Rights.*

We are witnessing the gradual transition from a fishing industry that has been open to an unlimited number of participants to a variety of fishery-specific limited entry systems. We have discussed above the current status of access limitations based on the citizenship of the participant. The Magnuson-Stevens Fishery Conservation and Management Act<sup>28</sup> provides a mechanism that allows regional fishery management councils to set annual catch limits for each species of fish on each fishing ground. Also, under this law there have been implemented, or there are under development, a number of regulatory schemes that allocate the annual catch limits (“total allowable catches” or TACs) among the industry’s participants. These systems are often very complicated, with the allocations to their participants based on a variety of factors: historical participation in the fishery, catch history, and the like. There have also been allocations to native communities. As a further complication, the transferability of these fishery participation interests varies with each fishery. For example, some are readily transferable, and others can be transferred only if the vessel that utilizes the fishery participation is transferred at the same time, with exceptions in some cases for transferring the rights associated with sunken vessels or the like.

The most recent development in this area is a proposal for rationalization of the Alaska crab fisheries that has been proposed to the Congress by the North Pacific Fishery Management Council. This proposal can be reviewed at the following website: [www.fakr.noaa.gov/npfmc](http://www.fakr.noaa.gov/npfmc).

Also, in some fisheries sectors, the participants have entered into cooperative agreements by which they allocate the TAC among themselves. The offshore segment of the west coast Pacific whiting fishery and the Bering Sea pollock fishery are prominent examples.

A lender needs to know in what fisheries its borrower intends to operate, exactly what fishing rights the borrower needs to operate in those fisheries, and whether the borrower owns the necessary fishing rights or has arranged for other means to gain access to those fisheries. These arrangements need to be scrutinized. A divorce for example, can complicate a fisherman’s entitlement to the fishing rights needed to operate the business.

The National Marine Fisheries Service (“NMFS”) takes the position that fishery participation interests that are based on federal law represent “privileges,” rather than “rights,” in an effort to prevent their categorization as “property” interests subject to the Fifth Amendment’s prohibition against the “taking” of such interests by the federal government without “just compensation.” Obviously, NMFS wishes to retain flexibility to change these limited entry schemes without subjecting the government to lawsuits for the lost value of these participation interests. Although lenders should be cognizant of the distinction that NMFS has tried to make between a right and a privilege and should be aware that a borrower’s “fishing rights” may be subject to modification or termination by regulatory action, in this article we will use the common term “fishing rights” to refer to all fishery participation rights, privileges or interests, however described and from whatever source.

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<sup>28</sup> 16 U.S.C. §1801 et seq.

The implementation of a limited participation regime in a fishery presents issues to lenders that have long been recognized: When a system of fishing rights is created, a good part of the going concern value and the collateral value of a fishing enterprise becomes embodied in the fishing rights, rather than the enterprise's vessels. It follows that the financeability of the industry depends in good measure on the ability of lenders to take enforceable security in fishing rights. Some recent cases handed down by the courts have raised serious questions about how this should be done.

Initially, the consensus view of maritime lawyers was that fishing rights were general intangibles under the Uniform Commercial Code and that the proper method to take security in them was to have the borrower grant a security interest in them (sometimes referred to as an assignment of fishing rights for security) and file a UCC financing statement. In addition, it has become the practice for the lender to take possession of any documents representing fishing rights that are not required to be kept aboard the fishing vessel itself. In Alaska, the NMFS office that administers the limited entry systems in place for the federal fisheries off Alaska has developed an informal, but potentially useful, practice of keeping a record of lenders who notify the office that they have a security interest in particular fishing rights. The office makes it a practice to give such lenders notice when it receives a request to transfer fishing rights subject to a security interest of which it has notice, so that the lender has a chance to protect its interests. NMFS will also record the existence of a security interest in favor of a lender on the documents evidencing fishing rights for some limited entry programs. Even though this is probably not a requirement for perfection, it is a useful way to get potential transferees to contact the lender before attempting to purchase the collateral, and it can serve as a reminder to NMFS personnel to contact the lender before processing a transfer.

As a result of the foregoing, lenders have developed a practice of sending written notice to NMFS of their security interests in a particular borrower's fishing rights and requesting that NMFS note their security interest on the fishing rights documentation, where appropriate. Lenders now also typically include in their loan documentation a power of attorney granted by the borrower to allow the lender to deal with NMFS in the borrower's name on default and foreclosure.

Lenders taking security in fishing rights in a sector in which the participants in the sector have allocated the TAC among themselves through a fishery cooperative agreement must also take care to assess their collateral position in light of the borrower's participation in the cooperative scheme.

There is usually a requirement that the holder of fishing rights be a U.S. citizen. This is sometimes expressed as a requirement that the holder be a person entitled to document a vessel, or to document a fishing vessel, under the federal vessel documentation statute. The latter standard probably now means a person satisfying the 75% U.S. citizen ownership and control requirements of the AFA (or a vessel owner grandfathered under section 213(g) of the AFA). Accordingly, a lender that is eligible to hold a preferred mortgage on a fishing vessel under the AFA lender amendments would not necessarily be eligible to hold the related fishing rights. Therefore, lenders who cannot demonstrate that they satisfy the AFA's U.S. citizen ownership test need to take care how they foreclose security interests in fishing rights. Thus, taking title to

a fishing right outright in an offset bid could present some risk. It would be better to hold a public sale under conditions that allow the lender to bid, but to withhold “confirmation” of the sale for a brief period to permit the lender to sell to an eligible entity the right to acquire the fishing right and to take “confirmed” title.

The general system described above, in which UCC security interests were taken in limited entry fishing rights and supplemented in the various ways mentioned has worked quite well over the years since the introduction of fishing rights as separate assets to which security interests might attach. Congress enacted a statute in 1995<sup>29</sup> that directed NMFS to develop regulations to implement a system to record ownership, transfers, and security interests in fishing rights. This was not implemented by NMFS, however, due to practical problems associated with designing such a recording system and more theoretical concerns that the statute was inconsistent with the NMFS policy of treating fishing rights as “privileges” instead of property rights.

Then, in 1998, in an unpublished decision, the U.S. District Court in Seattle ruled that a preferred ship mortgage on the fishing vessel *TENACITY* that specifically includes fishing rights in the collateral description could attach to and create a preferred mortgage lien on a vessel’s fishing rights. It also held that if a preferred mortgage did not mention fishing rights specifically, the mortgage did not attach to them. In that case, the court held that the “first” preferred mortgage, that did not mention fishing rights, had a first priority position in the vessel, but was not perfected against the fishing rights, and the second preferred mortgage, which did mention fishing rights, had first priority in the fishing rights. This case was not appealed. In this decision the court drew an analogy between the attachment of a mortgage lien to fishing rights and the attachment of such liens to “freights” -- i.e., the receivables payable by shippers for the transportation of their cargo on commercial transport vessels. The court discerned a general principle that maritime liens may attach to intangible rights that arise from the operations of a vessel, and it applied this “principle” to fishing vessels and fishing rights awarded to the vessel owner on the basis of the vessel’s prior operating history. At about the same time, in another Seattle case that was appealed to the Ninth Circuit Court of Appeals, the issue whether fishing rights were subject to lien and could therefore be sold with a vessel at a Marshal’s sale was assumed but not contested.<sup>30</sup>

Subsequently, in a case in the U.S. District Court in Maine, the court found that an ordinary maritime lien for ship repair services rendered to a fishing vessel also attached to the vessel’s fishing rights, and the First Circuit Court of Appeals affirmed the decision.<sup>31</sup> Here, however, unlike what is most commonly the case in the Pacific Northwest, the courts were dealing with fishing rights that can usually only be transferred with a specific vessel. In these

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<sup>29</sup> 16 U.S.C. §1855(h)

<sup>30</sup> *Bank of America v. F/V PENGWIN*, 1998 A.M.C. 1148 (W.D. Wash. 1997), 175 F.3d 1109, 1999 AMC 1905 (9<sup>th</sup> Cir.), *cert. denied*, 528 U.S. 872 (1999).

<sup>31</sup> *Gowen, Inc., v. F/V QUALITY ONE*, 2000 A.M.C. 2225 (D. Maine), *aff’d* 244 F. 3d 64 (1<sup>st</sup>. Cir. 2001). In unreported decisions, the District Court in Massachusetts ruled similarly, and the First Circuit followed its decision in *Gowen*, in unreported decisions, and the U.S. Supreme Court then denied a petition for a writ of *certiorari* in *Daniels v. Patenaude*, 534 U.S. 1039, 122 S. Ct. 613, 151 L.Ed. 2d 537 (2001).

circumstances, the courts stated that the fishing rights were “appurtenant” to the vessel, just like pieces of equipment, and were similarly subject to a vessel’s maritime liens.

While we believe that, as a matter of law and good public policy, the *TENACITY* case in Seattle is in error, and we have our reservations about the Massachusetts cases as well, it of course follows that as a matter of prudence, lenders financing a borrower’s fishing rights need to specifically describe the fishing rights in the preferred mortgage taken on the borrower’s vessel. Taken together, however, these court cases raise more questions than they answer. For example, assume that the historical fishing activity of an owner of fishing vessel A gives rise the issuance of a fishing right. Assume that the fishing right is sold to a second owner, who also owns and uses the fishing right on vessel B. Then assume that the second owner leases the use of the fishing right to a third person, who uses the fishing right on vessel C. Which vessel’s liens can attach to the fishing right? The set of doctrines that were relied upon by the Seattle court would logically suggest that vessel A’s liens attach, but not B’s and C’s. A simple application of the result of the Massachusetts court’s decision to a fishery with transferable fishing rights would suggest that the liens of all of the vessels would attach depending on which vessel was using the fishing right at the time the liens arose. If this becomes the law, it will not be a helpful development for the fishing industry and its financeability.

Since the law is unsettled, what is a lender to do regarding due diligence to determine whether the lender’s security interest is subject to prior unrecorded liens? A second question related to this is how good is the borrower’s own title to the fishing rights if he or she has purchased the fishing rights from someone else? The cost of analyzing the credit history of every vessel that has used transferable fishing rights could add significantly to the transaction costs of borrowers and lenders.

The State of Alaska limited entry permit system for salmon takes pains to specify that only the Alaska Commercial Fishing and Agriculture Bank can take a security interest in a state salmon permit.<sup>32</sup> The Seattle and Massachusetts cases, in tandem with the general principle that federal maritime law supersedes state law, would suggest that maritime liens may attach to these permits, as well, notwithstanding the restrictions of Alaska law.

There is clearly a need for legislation to bring some order to this situation. We believe that well-crafted legislation is needed soon, before the cases that hold that fishing rights are subject to preferred mortgage liens and unrecorded maritime liens become well-settled law.

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<sup>32</sup> A.S. 16.43.150(g)(1).

