

MARSHALL ISLANDS

Section 112 of Title 47 of the Marshall Islands Revised Code is amended by inserting therein in appropriate alphabetical order the following definitions:

“documented owner” with respect to a vessel means the person identified as the owner of a documented vessel in the application for documentation filed for the vessel with the Commissioner or any Deputy Commissioner. A person who retains only legal title to a vessel may be a documented owner, notwithstanding any transfer by such person of all or any part of its equitable or beneficial ownership interest in such vessel.

“financing charter” means a contract in the form of a demise or bareboat charter, regardless of duration, between the documented owner and the finance charterer of the entire vessel, which contract is agreed by the parties to be or is determined in judicial or arbitral proceedings to create in favor of the documented owner a security interest in the vessel granted by the finance charterer.

“finance charterer” means a person identified in a financing charter as the charterer of a vessel.

“owner” for purposes of Sections 208 and 214 shall include any person who at least holds title in a vessel.

A new Section 302 is added as follows:

Section 302A. Registration, Recordation, and Discharge of Financing Charters

(a) Without adversely affecting the documentation or the eligibility for documentation or the renewal of documentation of a vessel, a documented owner and a charterer may execute a contract in the form of a demise or bareboat charter and either the documented owner or the charterer may register for recordation a true copy thereof with the Commissioner or Deputy Commissioner with respect to a vessel documented in the name of such documented owner. Such contract shall be signed and acknowledged by the documented owner and the charterer and shall include the name and official number of the vessel, the date of such contract, the names and addresses of the documented owner and the charterer and the aggregate of the nominal amount of all charter hire payments and purchase option amounts payable or which may become payable thereunder, exclusive of any interest, indemnities, expenses or fees. A security interest in a vessel in favor of a documented owner evidenced by any such contract which is a financing charter, which is registered for recordation in substantial compliance with this Section 302A, shall be deemed to be a preferred mortgage on the vessel in favor of the documented owner for all purposes, effective for all purposes as of the date and time of filing. All the provisions of this Chapter 3 shall apply to any contract filed in accordance with this Section 302A that is a financing charter.

(b) A documented owner may also register for recordation any renewals, amendments, supplements, assignments or other instruments related to any contract filed pursuant to paragraph (a) of this Section 302A.

(c) A documented owner shall have the power to grant one or more preferred mortgages encumbering the whole of a vessel, and any supplements, amendments, assignments or other instruments related thereto, notwithstanding that such documented owner or predecessor in interest shall have entered into any contract which is deemed to be a preferred mortgage on the vessel pursuant to paragraph (a) of this Section 302A.

(d) The mere registration or recording of a contract as a financing charter hereunder shall not constitute evidence that such contract in fact is a financing charter or that it creates a security interest. No agreement between the parties thereto that a contract constitutes a financing charter shall be binding on any other person or any government not in privity.

(e) With respect to any financing charter, the documented owner party thereto shall be deemed a mortgagee under a preferred mortgage and the finance charterer shall be deemed the mortgagor, for all purposes under the statutes and Rules of Court of the Republic of the Marshall Islands.

Section 317 is amended by adding a sentence at the end thereof as follows:

“As used in Sections 302A, 303, 311, 316, 318 and 320 of this Chapter, the term Preferred Mortgage also means a financing charter of a foreign vessel that has been registered in a public registry at the port of registry of the vessel or at a central office (i) in the foreign country under whose laws the ownership of the vessel is registered in the name of the person stated to be the owner in the financing charter, and (ii) if applicable, in the foreign country under whose bareboat charter registry laws the financing charter of the vessel is registered in order to permit the vessel to sail under the flag of such foreign country.

NOTES AND COMMENTARY

Statement of Purpose

The Marshall Islands Maritime Law, codified as Chapter 3 of Title 47 of the Marshall Islands Revised Code, as Amended, should be further amended in order to enable equipment lessors who provide lease financing of vessels the same security in collateral enjoyed by lessors of non-maritime property. A lessor under a financing charter filed pursuant to this proposed amendment would enjoy the same priority as a mortgagee enjoys currently under a preferred mortgage. The proposed amendment would permit perfection of security interests in leased vessels in line with provisions of the Uniform Commercial Code (“UCC”), enacted in all fifty States of the United States and the District of Columbia, as well as 49 U.S.C. Sections 11301 (as to rolling stock and appurtenances) and Section 44107 (as to aircraft and appurtenances). It would also be consistent with the concepts and provisions underlying the Convention on International Interests in Mobile Equipment (Capetown, November, 2001) with respect to aircraft, railcars and space vehicles.

Background

Prior to the enactment of various national statutes creating ship mortgages or hypothèques, there was no adequate legal device whereby loans to a shipowner could be secured by the vessel itself. Generally speaking, this new “preferred mortgage” stood in rank only below certain historically superior maritime liens, such as salvage, general average, crew wages, maritime tort claims and lesser maritime liens arising prior in time to the filing of the preferred mortgage. The preferred mortgage device has been enshrined in U.S. statutory law ever since 1920. Similar vessel mortgage statutes exist in most, if not all, maritime nations of the world. Several international conventions have been done in attempts to harmonize the recognition, priority and enforcement of such mortgaging instruments.

For historical reasons, the Marshall Islands Maritime Law, including the provisions on preferred mortgages, is originally derived from U.S. legal concepts and practices, but has since evolved to include a number of more recently accepted concepts. However, at this time, only a person in whose name a vessel is documented can grant a preferred mortgage on that vessel. If the vessel is documented in the name of the financier, who then charters the vessel to the customer in a standard lease financing structure, and the charter is agreed to be or is found to be a security agreement, as opposed to a true lease, the financier has no meaningful protection in the event of bankruptcy. This has been a strong disincentive to a number of leasing products in the shipping space.

In the meantime, land-based concepts of security interests have evolved, leaving the laws of ship mortgaging behind. For example, in 1920, when the U.S. Congress passed the Ship Mortgage Act, the UCC was not yet in existence. Now, Article 9 of the UCC governs all security interests in personal property, except when Article 9 is displaced by provisions of federal law, including the Ship Mortgage Act, as to vessels; the Surface Transportation Act (49 U.S.C. Section 11301 *et seq.*), as to railcars and some undocumented vessels, principally barges; and the Federal Aviation Act (49 U.S.C. Section 44107-11), as to aircraft; and certain state certificate of title statutes, particularly governing vehicles (UCC 9-311). Notwithstanding the

foregoing exceptions, the vast majority of equipment financed in the United States can be financed with the security interest devices set forth in Article 9 of the UCC.

UCC Article 9 itself is, in large part, a codification of existing common law of chattel mortgages, harmonized by consensus of its drafters and subsequent adoption by the state legislatures. In place of terms such as “pledge” and “chattel mortgage,” the UCC chose the terms “security interest” and “security agreement.”

UCC 9-102 defines “security agreement” as “an agreement that creates or provides for a security interest.”

UCC 1-201 (37), in turn, defines a security interest in relevant part as “an interest in personal property or fixtures which secures payment or performance of an obligation.... The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer...is limited in effect to a reservation of a security interest.”

UCC Article 9 and the abundant case law which has construed it recognize that many documents styled as leases are, in fact, “security agreements” under the UCC and that the property rights of the title-holding lessor under such agreements can only be protected by the filing of a financing statement covering the leased property and naming the lessee as “debtor” and the lessor as “secured party.” The UCC recognizes that the title holder may not, in fact, hold the true ownership interest in the property. For this reason, UCC 9-202 specifically states that “the provisions of [Article 9] with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.” As presently enacted, the Marshall Islands Maritime Law, like the U.S. Ship Mortgage Act, does not have the flexibility to permit the filing of a mortgage or lease in favor of a person in whose name the vessel is documented.

Equipment leasing as an industry has exploded in the past fifty years to provide a number of lease-based financing vehicles which are advantageous to users of such equipment. However, the benefits of these equipment financing vehicles have been far less available to the marine industry for several reasons. First, unlike the security interest device under the UCC, the Marshall Islands Maritime Law only permits the filing of a mortgage granted by the person in whose name a vessel is documented and does not allow perfection of a security interest granted by a charterer (lessee) under a charter; second, it is unclear whether any security interest in a vessel (other than a preferred mortgage granted by the documented owner) can be perfected by filing of a financing statement; and, third, even if a UCC filing were deemed to perfect such security interest in a chartered vessel in favor of the documented owner, the relative value of such a security interest, when placed in the ranks of priority and preference of maritime liens, makes the security interest, in most cases, of little or no practical value. The proposed amendments would add important security protections for lease transactions and enhance their availability to the industry.

Assume, for example, that a vessel operator wishes to acquire a vessel by charter. The vessel operator selects the vessel and requests a leasing company to purchase the vessel and then charter it to the vessel operator over a five-year or ten-year charter term, perhaps with a fixed price purchase option during or at the end of the charter term. Such an agreement, while called a “charter” and bearing certain features of a traditional charter, could potentially be characterized

as a security agreement in any bankruptcy of the charterer. In the event that the charterer files in bankruptcy under U.S. law or a similar system in another country, the bankruptcy court might determine that the vessel is, in fact, the charterer's property, subject to a security agreement in favor of the documented owner. If that occurs, under current law, the documented owner would have no ownership rights and no preferred mortgage or other maritime lien on the vessel and, at best, might have a perfected UCC lien on the vessel, subject to all maritime, tax and other liens.

Similarly, if a trade creditor or tort plaintiff were to arrest the vessel and assert a maritime lien, any UCC security interest would be primed by all maritime liens, tax liens and even mechanic's liens.

The consequence of the present regime is that many financial institutions are reluctant or unwilling to enter into lease financing of vessels in the United States. When they do, the pricing of those transactions results in a higher cost to the shipping community because of the higher risk involved.

The proposed amendments, if enacted, would provide those seeking to obtain the use of vessels the same financing alternatives now available to persons seeking to finance all other types of personal property, and at a lower financing cost than is currently available.

Section-by-Section Analysis

(a) Several new definitions are added to the Marshall Islands Maritime Law, Section 112, in order to clearly establish that a "documented owner" is a person in whose name a vessel is documented with the Commissioner or Deputy Commissioner, regardless of whether such person may be found to have transferred all or most of its rights or benefits of ownership in the vessel.

"Financing Charter" is defined in such a way as to mean a lease which is actually a "security agreement" under the UCC.

"Finance Charterer" is defined to be essentially a lessee debtor under a financing lease.

(b) Section 302A(a) is a new Section to permit the registration and recording of a financing charter as the equivalent of a preferred mortgage against the vessel. This Section tracks the existing provision of Section 31321 as it requires the inclusion of certain recitations of information about the charter, the vessel and the parties and the formalization of the charter in order to permit the establishment of the financing charter as a "preferred mortgage" on the vessel in favor of the documented owner. While the UCC requires and, in fact, encourages only simplified notice filings in financing statements in order to perfect a security interest under Article 9, the drafters of the instant provisions concluded that the more expanded informational requirements and the requirement to file a copy of the entire charter would be more consistent with current filing requirements applicable to traditional "preferred mortgages."

(c) Section 302A(b) would permit the documented owner to register for recordation any renewals, amendments, supplements, assignments or other instruments related to any filed charter. This provision tracks the permissive registration provisions applicable to the registration of equivalent instruments affecting traditional preferred mortgages.

(d) Section 302A(c) would permit a documented owner to grant preferred mortgages and related instruments with respect to a vessel, notwithstanding the fact that the documented owner shall have transferred a great percentage of the beneficial ownership interest in a vessel to a finance charterer under a financing charter. In many situations, a documented owner may have transferred less than all of the beneficial ownership interest in a vessel under a financing charter, even though the finance charterer may be deemed to be the true owner. In many close situations, the parties may be uncertain as to whether the lease will be deemed a “true lease” or a “security agreement.” Section 302 is intended to recognize that the documented owner may still have a residual transferable interest in the vessel which can be “back leveraged.” The documented owner and the charterer would always have the ability to negotiate restrictions on the documented owner’s ability to make subsequent transfer of any interest or to place additional debt on the vessel. On the other hand, the parties may agree that such subsequent transfer may be useful to the charterer to further reduce the cost of the credit extended by the documented owner. Priority between a financing charter filed as a preferred mortgage and a conventional preferred mortgage would be determined by order of filing unless the parties entered into an intercreditor or subordination agreement which alters priorities, *inter sese*. This would be in line with the law and practice of equipment leasing as it already exists for all equipment except vessels.

(e) Under Section 302A(d), the filing of a contract as a financing charter provides a safe harbor to eliminate the risks of recharacterization in bankruptcy but does not determine the question of whether a contract is, in fact, a true lease or a security agreement. Section 302A(d) would provide that the mere filing of a document under these financing charter provisions does not, in and of itself, establish that it constitutes a financing charter. This determination would be left to the courts under existing jurisprudence. Additionally, this new Section would permit lessors to enter into new charters which they believe to be “true leases” and have the financing charter filing as security against the risk that a bankruptcy court or U.S. District Court in any vessel foreclosure might recharacterize the contract as a security agreement.

(f) Section 302A(e) would establish the financing charter as the equivalent of a preferred mortgage against the vessel and, together with a conforming amendment in existing Section 302, gives the documented owner the same rights and remedies available to a preferred mortgagee.

(g) In Section 317, the existing definition of requirements for a preferred mortgage would be expanded to permit financing charters on foreign vessels to be treated as preferred mortgages in Marshall Islands courts in the same way that existing foreign “mortgages, hypothecations and other charges” are already accorded treatment as preferred mortgages under Marshall Islands and U.S. law as set forth in existing Section 302 of the proposed amendment. The new language also requires registration of a financing charter in the bareboat charter registry of any foreign country under whose flag the vessel is operating, other than the vessel registration state.

Recognition Outside the Marshall Islands

Because the amendments would bring the financing charter into the definition of “Mortgage,” and it is, in part, a well-recognized pledge of the vessel and meets the requirements

of publication and central filing, the status of the financing charter as a “preferred mortgage” should be recognized by the courts of all traditional maritime nations either pursuant to their national statutes, international convention or common law of comity.

What If My Parties and Vessel Are Outside the U.S.?

Parties situated in jurisdictions where recharacterization of financing leases as security agreements is not a risk may be tempted to shrug at this proposal. But there are benefits to those parties as well. In the first instance, there is no downside to an owner filing a charter as a financing charter. Second, such an owner may be in position to claim its charter is in fact a preferred mortgage in cases when the finance charterer has collapsed but left the vessel buried in maritime liens. In those cases, the owner could assert its preferred mortgage lien from the financing charter to defeat a number of claims that would prime a simple claim of owner. Third, since vessels trade across borders, an owner of a finance chartered vessel would have some safeguards in the event that a vessel were arrested in the U.S. or a jurisdiction with similar views on recharacterization of financing leases based on an “economic realities” analysis. Considering the low threshold for foreign shipowners to commence Chapter 11 proceedings in the United States, this provision is of even greater use to the non-U.S. ship lessor.