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Maritime Law and Insolvency

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Andrew is a specialist in maritime and international trade matters. He is an expert in arbitration, litigation and mediation and is the head of the Maritime and International Trade team in Hong Kong. Andrew has particular experience in jurisdiction disputes and in obtaining injunctions in support of litigation and arbitration.

The Baltic Dry Index, the barometer of the health of the shipping industry, plummeted overnight in 2008, despite hopes to the contrary it has not recovered since and in 2016 hit its lowest level ever. Notwithstanding the numerous maritime insolvencies we have seen over the last few years, we expect that there will continue to be difficulties for the maritime industry.

Maritime law with its ancient and mysterious origins presents both opportunities and challenges to parties working to rescue, restructure or liquidate companies involved in the maritime industry.

A primary concern in the maritime industry is that it is almost entirely an international business. Readers may remember the 2002 sinking of the *MV Prestige* off the Spanish Coast causing one of Europe's largest environmental disasters. Many headlines highlighted the international nature of shipping: the vessel was Greek operated, registered in Bahamas, owned by a Liberian special purpose vehicle, insured in London, carrying oil from Nigeria to the Netherlands, broke up on the Spanish coast and caused damage in Spain, France and Portugal. Cross-border issues are therefore the norm.

More recently, the collapse of the OW Bunkers Group ("OWB") in Denmark, a major supplier of marine fuel to the shipping industry, has highlighted other features of the maritime industry which has profound effects for the insolvency and restructuring industry: maritime liens and arrest. The fact that vessels sail from one country to another, means that they are exposed to the risk of arrest in each one of those countries, each with its own regime and understanding of maritime liens. Attempts have been made to harmonise these features, however, interpretation of legal principles and features remain very much localised.

This article will attempt to highlight some of the features of the maritime industry that may have an impact on the unwary.

Flags of convenience

The Panama papers affair caused very little surprise amongst the shipping community. This is because shipping companies have for

many years sought to diversify their risk through complicated offshore structures and flags of convenience.

The question of risk for shipowners is significant. Ships in the same ownership may be vulnerable to arrest, even if that ship is not involved in the incident that gives rise to the arrest event.

This can have a significant impact on the cash flow of a shipowner: many ships are hired out (chartered) by their owners to an operator in order to ensure an income stream. However, if the ship is arrested the charterer may be able to stop paying hire to the owner.

Flags of convenience have been a feature of international shipping since the 1950s. This is a practice where a merchant ship is registered in a country different from the country of the shipowner. The ship will then fly the flag of the registered country and will operate under the law of the flag. In addition to risk diversification there may be added benefits such as a reduction of operating costs, a more liberal regulatory regime (such as employment terms) or tax advantages.

This kind of complex corporate structure with a myriad of cross-border issues presents a challenge in an insolvency or restructuring situation, however, will be familiar to practitioners involved in cross-border insolvency. Less familiar will be the archaic ability to arrest a vessel for *in rem* claims.

Arrest and claims *in rem*

Arrest in some senses is the nuclear weapon of maritime law. It can allow claimants to leapfrog the ordinary order of payments and it can reorganize the order of priorities that we are used to. It can also be deployed against any ship owned by the same party.

An arrest allows a claimant to obtain a judicial order to restrain a ship from leaving a port and if necessary sell the ship and satisfy his claim out of the proceeds of sale.

It is a powerful tool in forcing either security for a claim to be provided or forcing a shipowner to pay for a claim. The reason it is of concern to insolvency and restructuring practitioners is because the claim is not against the company but against the ship itself.

Although the kinds of claim that can give rise to an arrest are wide, they are limited to specific maritime claims known as *in rem* claims. *In rem* claims have two sources (1) maritime liens, which derive from maritime tradition and (2) Statutory claims *in rem*.

Under Hong Kong law (and in most common law jurisdictions – with some notable exceptions which we will set out below) maritime liens are (1) Damage done by a ship (2) Salvage (3) Crew wages (4) Master's wages and disbursements; statutory claims *in rem* are set out in the High Court Ordinance (elsewhere other implementing legislation).

In most littoral countries legislation has been enacted to bring into force the provisions of the 1952 Convention on the Arrest of Seagoing Ships which attempts to harmonise the causes of action leading to an arrest. However, jurisprudence and tradition in different countries has led to different treatment of *in rem* claims. For instance claims for insurance premiums can lead to arrest in Estonia, but not England.

Upon arrest and sale of a vessel the proceeds of sale are, prima facie, at the discretion of the court distributed as follows:

1. The Admiralty Marshal's costs and expenses connected with the arrest of the vessel and its appraisement and sale;
    a. The costs of the arresting party, and
    b. The costs of the party who obtained the order for the appraisement and sale of the vessel, for the period up to and including the order itself.
2. Maritime liens
3. Possessory liens
4. Mortgages
5. Other statutory actions *in rem*
6. *In personam* claims

It can be seen therefore that claims that would not normally be secured, such as maritime liens and possessory liens are leapfrogged ahead of secured claims. Furthermore, statutory *in rem* claims enjoy priority over ordinary unsecured claims.

The essential difference between statutory *in rem* claims and maritime liens is that a statutory *in rem* claim only crystalises upon the issue of proceedings. A maritime lien arises at the time of the underlying cause of action. Therefore if the ownership or control of the ship changes between the time when

the cause of action arises and the issuing of proceedings a statutory *in rem* claim would be defeated (and the vessel could not be arrested). But the holder of a maritime lien can still arrest the vessel even if the vessel has been sold.

The OWB collapse has thrown into sharp relief some of the issues that arise with insolvency and *in rem* claims.

In early 2014 OWB listed on the Danish Bourse raising nearly US$1bn. OWB supplied some 7% of the world fleet with marine fuel – bunkers. OWB was however, only a trader, it did not physically place bunkers on board ships. Within 6 months, OWB filed for insolvency.

In general terms OWB's business model was as follows: a shipowner would place an order for bunkers with OWB, who would then order them from a physical supplier who would place the bunkers on board the ship. Usually the contractual chains would be far longer and more complex than this.

The supply of bunkers was usually on credit terms and usually the contracts would contain retention of title clauses. When OWB filed for insolvency in November 2014, many shipowners had received bunkers on board but had not yet paid for them. Ordinarily there would be no difficulty, the liquidator (or in this context the receiver appointed by the bank under a security instrument) would gather in the debts owed to OWB.

However, the supply of bunkers to a ship is in fact an *in rem* claim. It is an *in rem* claim held by anyone in the supply chain. Shipowners were therefore presented with the proverbial Hobson's choice: pay the receiver/liquidator and face a potential arrest and claim against the ship, or pay the physical supplier and face a claim in contract from the receiver/liquidator.

Furthermore, different jurisdictions around the world treat the supply of bunkers differently. In most common law jurisdictions the supply of bunkers is a statutory *in rem* claim, whereas in the USA and Panama the supply of bunkers is a maritime lien.

In most common law countries, the law applying to the classification of a claim as a statutory *in rem* claim or a maritime lien is local law. However, in a recent Australian case the court held that a supply of bunkers was a maritime lien because the supply was made in Panama, even though under Australian law the supply of bunkers was only a statutory claim.

Several legal challenges have been mounted around the world to try to resolve the impasse. In England the matter has now been considered by the Supreme Court. The shipowner contended that he should not pay OWB as OWB had never in fact sold the bunkers to him. Due to the credit terms and the retention of title clause, OWB had failed to pass title in the bunkers to the shipowner. In a radical change to the law the Supreme Court held that the sale of bunkers was not in fact a sale contract where OWB had promised to transfer title. It held that the shipowner was obliged to pay OWB. However, it did not resolve the issue with the physical supplier who arguably still has an *in rem* claim against the shipowner in respect of the bunkers.

In Canada, the shipowner paid the bunker price into a trust account and asked the court to decide who should be paid. The Court decided that OWB was entitled to its margin and the principal sum should be paid to the physical supplier. The decision has been appealed and has been heard by the appeal court. A decision is awaited. In New York there are over 20 pending cases similar to the Canadian case. All of which are awaited eagerly by shipowners and the receivers of OWB alike.

This state of uncertainty globally as to how claims should be treated and the ensuing priorities serves to underline the fact that maritime insolvencies hold many pitfalls for the unwary.