The Case for a New Protocol to the Cape Town Convention Covering Security over Ships*

A. Introduction

The 2001 UNIDROIT Convention on International Interests in Mobile Equipment (hereinafter: Cape Town Convention) is regarded as being one of the most ambitious and successful international conventions in the field of private law.[1] In general, international legal harmonisation in the area of private law, specifically in the law of property, is a notoriously slow and difficult process and it often proves impossible to reach a broad international consensus which bridges the differences between states from different legal traditions and with different levels of socio-economic development.[2] The Cape Town Convention, however, has been able to attract wide-spread support world-wide, among its seventy-two State Parties are high-income economies, newly industrialised countries as well as developing countries and it includes countries from different legal backgrounds, whether civil law countries, countries from the common law world or other.[3]

With its unified, asset-based system of registration for mobile assets of high value, the Cape Town Convention has set an international standard for the regime of proprietary security in this type of assets. This standard is respected also under other international instruments developed by other international organisations, such as the UNCITRAL Legislative Guide on Secured Transactions.[4]

In the view of this immense success, it is perhaps somewhat surprising that the Cape Town Convention so far does not cover ships as one of the most obvious and most common examples of mobile assets of high value. This is even more so given the fact that while the market for secured finance in shipping is enormously huge,[5] this market is traditionally riddled with difficulties stemming to a large extent from an unsatisfactory legal framework especially as regards differences between the legal systems concerning the use and status of proprietary security in cross-border business, *i.e.,* legal difficulties that are typically regarded as arguing for legal harmonization.[6] In fact, in the very early stages of the development of the project that was to become the Cape Town Convention, the possibility of

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1 *Cf*. *Roy Goode*, The priority rules under the Cape Town Convention and Protocols, in: Cape Town Convention Journal 1 (2012), 95.

2 *Cf*. *Mark Sundahl*, The "Cape Town Approach": A New Method of Making International Law, in: Columbia Journal of Transnational Law 44 (2006), 339, at 341. See also *Charles Mooney*, The MAC Protocol: some comments and a challenge, in: Cape Town Convention Journal 4 (2015), 76, noting that with the exception of the success of the Cape Town Convention system, international efforts to harmonise secured transactions law have encountered many obstacles.

3 Source: http://www.unidroit.org/status-2001capetown.

4 See the recommendation 4 (a) of the UNCITRAL Legislative Guide on Secured Transactions, which exempts mobile assets covered by the Cape Town Convention from scope the application of the Guide.

5 At the height of the market in 2008, before the current crisis set in, the volume of the global shipping loan market (transaction volume) reached over US$ 90 billion, see the data referenced in the article by *Okan Duru*, The Ship Mortgage Crisis (2014), available for download under http://www.maritime-executive.com/article/The-Ship-Mortgage-Crisis-2014-10-23.

6 See *José Maria Alcántara*, A Short Primer on the International Convention on Maritime Liens and Mortgages, 1993, in: Journal of Maritime Law and Commerce 27 (1996), 219, at 232; *Ole Böger*, The Cape Town Convention and Proprietary Security over Ships, in: Uniform Law Review 2014, 24, at 59; *Roy Goode*, Battening down your security interests: How the shipping industry can benefit from the UNIDROIT Convention on International Interests in Mobile Equipment, in: Lloyd's Maritime and Commercial Law Quarterly 2000, 161, at 174 s.; *George Lord and Garrard Glenn*, The Foreign Ship Mortgage, in: Yale Law Journal 56 (1947), 923, at 940 s.; *Charles Haight*, Babel Afloat: Some Reflections on Uniformity in Maritime Law, in: Journal of Maritime Law and Commerce 28 (1997), 189, at 195; *Panayotis Sotiropoulos*, Liens for Necessaries and Arrest of Ships under Greek Law, in: Tulane Maritime Law Journal 12 (1988), 299, at 311.

covering security over ships had indeed been contemplated its drafters.[7] However, that idea was put aside already before the diplomatic conference in Cape Town took place:[8] It was argued then that the preparation of international rules governing ships and shipping was traditionally the preserve of specific international organisations with full participation of shipping circles. Moreover, there was concern about possible conflict with an already existing international instrument, namely the International Convention on Maritime Liens and Mortgages that was adopted only shortly before at the 1993 Geneva Conference of the United Nations and the International Maritime Organization.

However, twenty years later the time has now come for a re-assessment of the legal and economic case for a new Protocol to the Cape Town Convention covering security over ships. The business of shipping finance is in crisis[9] and other attempts to solve the problems stemming from the diversity of the regimes of maritime proprietary security, including the afore-mentioned 1993 Geneva Convention have not been successful.[10] Meanwhile, the idea to extend the Cape Town Convention to covering security over ships had never been fully forgotten and not only has it been repeatedly argued for in the academic literature[11] as well as - increasingly - from the market practice,[12] but also the relevant international organisations are appearing to resume their interest in a Protocol on Ships. The preparation of such an additional Protocol to the Cape Town Convention has been included, even if with a rather low priority as compared to other ongoing projects, in the current work programme of UNIDROIT:[13] In this context, a preliminary study on the feasibility of such a project has been presented to the UNIDROIT Governing Council in 2013,[14] and that study suggested that further research into this topic would be advisable. As of yet, UNIDROIT has not taken additional formal steps towards the preparation of a Draft Protocol and is still monitoring developments in this area, especially concerning the degree of industry support and the suitability of alternative approaches to current problems in shipping finance. The Comité Maritime International has also taken an interest in this issue. In 2014, it has set up a Working Group on Ship Financing Security Practices[15] which, however, has not yet taken a definite position on this issue but is currently undertaking preparatory work collecting data and information on current financing practices in the various shipping jurisdictions.[16]

The objective of this Paper is to assess whether a case exists for such a new Protocol to the Cape Town Convention covering security over ships. Such an assessment requires an analysis of the existing legal situation, of any relevant particularities of the business sector concerned and of the suitability of the Cape Town Convention model as compared to other possible solutions, such as action on a national level or the reliance on existing international instruments. As succinctly put by Professor Sir *Roy Goode*, the questions to be asked when considering the drafting of a new international instrument are: Is there a problem? Is there a

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7 See Article 2(1)(c) of the first set of draft articles of a future UNIDROIT Convention on Interests in Mobile Equipment, March 1996, UNIDROIT document Study LXXII – Doc. 24.

8 This criticism has been summarised in a memorandum issued by the UNIDROIT Secretariat, see UNIDROIT 1996, Study LXXII – Doc. 29. See also *Paul Larsen and Juergen Heilbock*, UNIDROIT Project on Security Interests, in: Journal of Air Law and Commerce 64 (1999), 703, at 724 (fn. 74).

9 See generally *Duru* (*op. cit.* fn. 5).

10 See below *sub* E.

11 See *Goode*, Security interests (*op. cit.* fn. 6), at 161 ss; *Böger* (*op. cit.* fn. 6), at 59.

12 See the law blog operated by the law firm Watson Farley and Williams: http://www.wfw.com/wp-content/uploads/2016/06/WFW-Briefing-Brazil-Non-Brazilian-Mortgages-Offshore-Assets-.pdf.

13 See the report of the 2013 General Assembly of UNIDROIT, A.G. (72) 9, at 6 and 20.

14 UNIDROIT 2013 - C.D. (92) 5 (c)/(d).

15 See http://www.comitemaritime.org/Ship-Financing-Security-Practices/0,27150,115032,00.html.

16 See the questionnaire published on the website of the Comité Maritime: http://www.comitemaritime.org/Uploads/Correspondence_President/Ship%20Finance%20security%20practices%20questionnaire%20final.pdf.

feasible solution? And is the project likely to receive a substantial measure of support not only from governments but from industry and other interested sectors?[17]

B. The present system of the Cape Town Convention and the Protocols thereto and its possible extension to ships

1. The Cape Town Convention and the existing and possible future Protocols thereto

The Cape Town Convention system, as it stands now, is comprised of the Cape Town Convention itself, which sets out the general principles of this system´s secured transactions regime for mobile assets of high value, and of the different Protocols to the Convention. The Cape Town Convention is not a stand-alone instrument and it can be applied to any type of mobile equipment only if this type of equipment is covered by one of the sector-specific Protocols to the Cape Town Convention. The following three Protocols have already been adopted: the 2001 Protocol to the Convention on International Interest in Mobile Equipment on Matters specific to Aircraft Equipment, which has attracted sixty-five Contracting Parties[18] and is therefore the most successful Protocol under the Cape Town Convention system by far, the 2007 Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Railway Rolling Stock[19] and the 2012 Berlin Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Space Assets,[20] the latter two not yet having come into force.

With these three Protocols, the Cape Town Convention system is now complete as regards all three categories of objects specifically enumerated in the Cape Town Convention itself, *i.e.,* aircraft industry assets (airframes, aircraft engines and helicopters), railway rolling stock and space assets.[21] However, the Convention envisaged the extension of the Cape Town Convention to objects of other categories of high-value mobile equipment through additional Protocols to be prepared by specific working groups created by UNIDROIT in co-operation with the relevant international organizations of that sector.[22] Currently, the work programme of UNIDROIT includes three additional Protocols. Work has already advanced on the preparation of a possible fourth Protocol to the Cape Town Convention on Matters specific to Agricultural, Construction and Mining Equipment:[23] A Study Group produced a Draft text for this Protocol over four meetings in 2014-2016[24] and the Governing Council of UNIDROIT has decided in May 2016 that a Committee of Governmental Experts should be convened on this issue in 2017.[25] Work on the other two possible Protocols is still in its early stages: Apart from the work on a Protocol on ships, there is also the project of a Protocol on renewable

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17 Cf. *Roy Goode*, From Acorn to Oak Tree: the Development of the Cape Town Convention and Protocols, in: Uniform Law Review 2012, 599, at 600.

18 Source: http://www.unidroit.org/status-2001capetown-aircraft.

19 The Luxembourg Protocol has so far been ratified only by Luxembourg and the European Union, http://www.unidroit.org/status-2007luxembourg-rail.

20 The Berlin Protocol has not yet been ratified by any State, see: http://www.unidroit.org/status-2012-space.

21 Article 2(3) of the Cape Town Convention.

22 Article 51(1).

23 On the topic of the development of this draft Protocol see *Henry Gabriel*, The MAC Protocol: we aren't there yet – how far do we have to go?, in: Cape Town Convention Journal 4 (2015), 67.

24 See the information on the UNIDROIT project website: http://www.unidroit.org/work-in-progress-studies/current-studies/mac-protocol.

25 See UNIDROIT 2016 C.D. (95) Misc. 2, para. 7.

energy equipment where the UNIDROIT Secretariat is currently intending to prepare a feasibility study.[26]

2. The function of the individual Protocols within the Cape Town Convention system

Each of the existing individual Protocols to the Cape Town Convention has a double function and the same would apply to any future Protocols: Such Protocols are not only necessary as instruments that provide for the application of the Cape Town Convention to the category of objects covered by the respective Protocols, but they also contain sector-specific rules, amending the general rules of the Cape Town Convention according to the needs of the different industry sectors.[27] Such rules might even go beyond the scope of the issues originally envisaged for the Cape Town Convention, as evidenced by the provisions in the draft Protocol on Matters specific to Agricultural, Construction and Mining Equipment concerning conflicts with security over immovable property.[28] Thus, dividing the Cape Town Convention system into the general Cape Town Convention and the industry-specific Protocols has several important advantages, one of them being that it was possible to restrict the text of the Covention to general rules on a regime of secured transactions for mobile assets of high value. Most importantly, however, is that this division allowed the drafting process for each Protocol to be organised according to the needs and requirements of the market participants and relevant organisations from the respective industry sector.[29]

This distinction between the Cape Town Convention and the different Protocols thereto means that the extension of the Cape Town Convention system to security over ships would not entail the wholesale application of the present regime for proprietary security over, for example, aircraft under the Cape Town Convention and the Aircraft Protocol to ships: Instead, the general principles under the Cape Town Convention on a regime of secured transactions for mobile assets of high value would be applied only subject to any amendment deemed to be necessary in relation to ships that could be agreed in the new Protocol itself.

3. Outline of the secured transactions regime of the Cape Town Convention and its possible extension to ships

By way of an outline, the Cape Town Convention's regime of secured transactions for mobile assets of high value includes the following core elements:

The most important feature of the Cape Town Convention is that it provides for an international interest,[30] *i.e.,* a proprietary interest whose creation, validity and effectiveness against third parties does not depend upon the fulfilment of any requirements under the secured transactions regimes of national law or upon any conditions for the recognition of foreign security interests.[31]

Publicity of international interests in mobile equipment, *i.e.,* ensuring that interested parties can obtain reliable information concerning the existence of such encumbrances, is

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[26] See the information on the current work programme in UNIDROIT 2016 – C.D. (95) 13 rev., at para 37.

[27] Article 6(2) of the Cape Town Convention.

[28] See Article VII of the Sixth Annotated Draft of the MAC Protocol, UNIDROIT 2016 – Study 72K – SG4 – Doc. 6.

[29] Cf. *Goode*, From Acorn to Oak Tree (*op. cit.* fn. 17), at 603 s.

[30] Article 7 of the Cape Town Convention.

[31] On the decision against earlier suggestions to follow a recognition-based approach see *Goode*, From Acorn to Oak Tree (*op. cit.* fn. 17), at 602.

paramount under the Cape Town Convention. The Convention provides for a system of publicity by registration in an international register specifically to be established for this purpose[32] and that operates as a real folio system[33] and is accessible for searching purposes to the general public in an electronic format.[34] Registration in this international register is determinative of the priority status of the international interest[35] and is required for the effectiveness of the international interest in insolvency proceedings against the debtor.[36]

As regards the priority status of competing international interests and other security rights under national law in the same assets, the Cape Town Convention lays down a clear system of priorities: Registered international interests have priority over any unregistered security, especially security under national law; as between competing international interests, priority is determined according to the order of the time of the respective registration in the international register.[37]

Strengthening the position of the creditor in the enforcement of the security against the debtor is another main objective of the Cape Town Convention: In the event of the debtor´s default, the creditor may take recourse to a harmonised set of remedies, including self-help remedies,[38] and appropriation of the collateral in satisfaction of the secured obligation is encouraged.[39]

By virtue of a possible Protocol on ships, these general rules of the Cape Town Convention could then be applied to security over ships as well: It will be considered below whether and to which extent the problems and risks that are currently encountered in the market for shipping finance[40] could be satisfactorily answered by the application of these rules.[41] As indicated above, an extension of the Cape Town Convention system to ships would not necessarily entail a wholesale application of the Cape Town Convention rules as applied, *e.g.,* to aircraft: Instead, a possible Protocol on ships could take into account the specific needs and peculiarities of the market for shipping finance, deviating from and amending these general rules as deemed necessary for this specific sector. While no decision has yet been taken by the relevant international organizations on whether formal negotiations on a possible Protocol on ships should be commenced, this paper will suggest some issues to be considered in the drafting of such an instrument,[42] reflecting the existing legal framework and peculiarities of the shipping finance sector.

D. Major legal problems concerning proprietary security over ships in cross-border transactions

Shipping finance is a business that is rarely purely domestic. Even where the financing transaction as such involves only parties from one jurisdiction, the ship itself is likely to move from one jurisdiction to another in the course of its commercial operation. Thus, even where a ship financing transaction has been concluded domestically, it could become necessary to enforce any proprietary security rights over the ship which the secured creditor has obtained

32 Article 16(1) of the Cape Town Convention.
33 Article 22(2).
34 Article 22(1).
35 Article 29(1).
36 Article 30(1).
37 Article 29(1).
38 Article 8(1).
39 Article 9.
40 See below *sub* D.
41 See below *sub* F.
42 See below *sub* G.

under this domestic transaction while the ship is within the jurisdiction of foreign courts. As will be shown below, however, virtually every aspect of the law of proprietary security over ships may give rise to significant risks and complexities once a cross-border element is involved. The following overview will show the main topics where differences as between the various national legal orders world-wide give rise to legal risks for secured creditors and other participants in the shipping finance market; the (limited) effects of existing international instruments intended to overcome these problems will be considered below.

I. Recognition of ship mortgages and hypothecations under foreign law

A primary concern for secured creditors holding (or considering to obtain) ship mortgages or hypothecations in cross-border business is whether and under which conditions these consensual proprietary security rights (*i.e.,* proprietary security rights created on the basis of an agreement of the parties) would be recognised under a foreign law.

In the absence of any international instrument providing for proprietary security over ships as an international interest, ship mortgages or hypothecations are currently created and made effective, usually by registration, under the rules of the applicable national law only. Generally, the question whether the various legal systems allow the creation of consensual proprietary security rights over a ship under their national law and permit, if required, the registration of these proprietary interests in the national shipping register is governed by the rule of the rule of the law of the flag:[43] This means that each State will allow the creation and registration of security over ships under its national legal system if the ship flies the flag of the State concerned, *i.e.,* if ownership of the vessel is registered in that State.

1. Widespread application of the law of the flag as governing law for the recognition of foreign ship mortgages and hypothecations

The question is then for secured creditors whether this creation and registration of their security rights under the law of the flag can reliably be expected to be recognised before the courts of another State. This might especially become relevant if the ship is arrested in another jurisdiction and proceedings are brought before the courts of that State. As a general matter, the acceptance or recognition of foreign property interests, especially if created or perfected under the requirements of foreign law or if providing different or more extensive rights than are known under the relevant domestic property law, is traditionally one of the most complicated issues of private international law. The widespread prevalence of a reference to the law of the *situs* of the collateral concerned as a rule of international property law in general is evidence of the reluctance of national property law regimes to accommodate the application of foreign property law and to recognise the existence and effects of proprietary interests under a foreign law.[44]

As concerns the recognition or acceptance of consensual security over ships, however, the application of the law of the situs has been to a large extent replaced by an application of the rule of the law of the flag: It is a widespread practice among legal systems world-wide that the law of the flag is not only applied for the creation of security rights over ships under domestic law but that also the question of the valid creation and third party effectiveness of

[43] See *Philip Wood*, Comparative Law of Security and Title Finance, ed. 2, Sweet & Maxwell 2007, paras. 39-073 s.

[44] *Cf. Hans Stoll*, in: Staudingers Kommentar zum Bürgerlichen Gesetzbuch, Sellier 1996, Int SachenR paras. 124 ss.

foreign security rights over ships is to be governed by the law of the State where ownership of the vessel is registered.[45] Such a reference to the law of the flag would in principle be sufficient to provide certainty for the market participants as concerns the applicable law for the creation and third party effectiveness of proprietary security rights over ships in a cross-border context:[46] Secured creditors can rely on the recognition of their proprietary security even before foreign courts as long as the requirements for the valid creation and third party effectiveness of the security under the law of the flag are fulfilled.

2. Exceptions: Jurisdictions that traditionally do not unreservedly apply the rule of the law of the flag

However, given the fact that, as stated above, the recognition of foreign security interests in general is an area that is highly in dispute, it is probably not surprising that regardless of this widespread reference to the law of the flag on this matter, there still appears to be a considerable insecurity among market participants as regards the status of proprietary security over ships under foreign law.

One important factor that contributes to this uncertainty is that is to be noted that there are still jurisdictions that traditionally do not, or not unreservedly, follow the rule of the flag. Even though this is a clear minority position among the jurisdictions world-wide, it cannot easily be predicted at the time of the conclusion of a security agreement providing for the use of a vessel as collateral to which jurisdictions the ship might sail during its operations. Therefore, the risk cannot be excluded with absolute certainty that an eventual dispute concerning the validity and effectiveness of the proprietary security could be brought before the courts of a State that does not unreservedly recognise ship mortgages and hypothecations under a foreign law of the flag, the jurisdiction of these courts to hear the dispute being based upon the arrest of the ship at its current location.

In international scholarly legal writing, there are references to a number of jurisdictions said traditionally not to recognise foreign ship mortgages and hypothecations under the rule of the law of the flag.[47] Some of these legal systems have, recently or earlier, in fact now reformed their law so as now expressly to provide for the recognition of foreign ship mortgages and hypothecations where the requirements for the valid creation and effectiveness of these rights under the law of the flag are fulfilled.[48] However, there are still jurisdictions where the application of the law of the flag cannot be unreservedly relied upon this respect: In Argentina, for example, foreign ship mortgages and hypothecations that fulfil the requirements for the valid creation and registration under the law of the flag are recognised only if reciprocity is ensured,[49] *i.e.,* if the court is satisfied that the flag State recognises ship mortgages and hypothecations under Argentinian law, which can introduce an element of uncertainty as to the reliability of the position of the secured creditor.

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[45] For a general overview, see *Sergio Carbone*, Conflits de Lois en Droit Maritime, in: Recueil des cours 340 (2010), 63, at 253 ss. See also, for instance, the situation in China: Maritime Code of 1993, Article 271(1); England: *The Angel Bell* [1979] 2 Lloyd's Rep 49; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), Article 45(1) Nr. 2; United States: 46 USC Section 31301(6)(B).

[46] See also *Sotiropoulos* (*op. cit.* fn. 6), at 312.

[47] See *Wood*, Security and Title Finance (*op. cit.* fn. 43), paras. 39-076, referring, amongst other jurisdictions, to the laws of Thailand, Turkey, Venezuela and the former South African province of Natal.

[48] See Thailand: Article 21 of the Vessel Mortgage and Liens Act 1994; for Turkey see Article 22 of the Code of International Private and Procedural Law 2007; Venezuela: *Decreto* No. 1.506 of 2001 *Ley de Comercio Marítimo* (Law of Maritime Commerce), Article 131.

[49] See *Ley* no. 20.094/1974 *Régimen de navegación* (Shipping Act), Article 600.

3. Exceptions: Application of the rule of the law of the flag denied by courts

A second factor that contributes to legal uncertainty in this respect is that even in jurisdictions that were previously not presumed to be adverse to the application of the law of the flag as governing law for the recognition of foreign ship mortgages and hypothecs, courts have sometimes thwarted the expectations of secured creditors holding ship mortgages and hypothecations under foreign law and decided to the contrary, *i.e.,* they have denied the recognition of ship mortgages and hypothecations created and registered under the provisions of the law of the flag instead of the law of the forum.

One example is the New Zealand case *The "Betty Ott"*.[50] In 1992, the New Zealand Court of Appeal had to decide in a case which involved a priority conflict in respect of a ship registered in Australia between an Australian registered mortgage and a later New Zealand security interested registered under the provisions of the law of New Zealand. The court held that priority between the competing security rights was to be determined under New Zealand law. For that matter, the security registered under the provisions of Australian law could not be recognised as equivalent to a domestic, *i.e.,* New Zealand mortgage, as this security right was not registered in New Zealand (and thus not of a type recognised under New Zealand law). As a result, the later security registered in New Zealand was afforded priority over the Australian security which was treated as unregistered.

This decision has been heavily criticised in the legal literature, where it was argued that the application of this rule would potentially deprive holders of registered ship mortgages of their security under all jurisdictions except for the State of registration.[51] The situation in New Zealand has since been remedied on the basis of the enactment of Section 70 of the Ship Registration Act 1992.[52] This provision expressly provides that ship mortgages and other security rights registered under a foreign law of the flag are recognised in New Zealand and given effect equivalent to New Zealand ship mortgages.[53]

A more recent example is the litigation in Brazil concerning the floating production storage and offloading unit (FPSO) "OSX-3", a Liberian-registered vessel used in the offshore oil industry in Brazilian waters. The BTG Pactual Banco S/A sought to recover USD 28 million as an unsecured creditor from OSX 3 Leasing B.V., a Dutch company who was the owner of the OSX-3. This claim was contested by the Nordic Trustee ASA as the holder of a registered Liberian ship mortgage over the OSX-3 who argued that any attempt by BTG Pactual Banco S/A to enforce its claim into the OSX-3 before the Brazilian courts would have to respect the priority of Nordic Trustee's rights under this foreign registered mortgage. Brazil is a party to the 1926 Brussels Convention on Maritime Liens and Mortgages[54] and to the 1928 Bustamante Code,[55] which both provide for the recognition of ship mortgages under foreign law, and this at least appeared to indicate that Brazil would follow this rule as a

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50 *The Ship "Betty Ott" v General Bills Ltd* [1992] 1 NZLR 655.

51 *Paul Myburgh*, Recognition & Priority of Foreign Ship Mortgages: *The Betty Ott,* in: (1992) LMCLQ 155, 158.

52 See *William Tetley*, Maritime Liens, Mortgages and Conflict of Laws, in: University of San Francisco Maritime Law Journal 6 (1993), 1, at 40.

53 Concerns whether this principle should also apply to security rights over ships of less than 24 meters length, in relation to which there is no registration requirement under the Ship Registration Act 1992 and which are also not excluded from the scope of the New Zealand Personal Property Securities Act 1999 (see Section 23 (e)(xi)) have been alleviated by the New Zealand High Court decision in the case *KeyBank National Association v The Ship Blaze* [2007] 2 NZLR 271, where it was held that the registration of a security under foreign law is to be recognised in such situations as well, see *Geoff Brodie*, Personal Property Securities: A New Zealand Maritime Law Perspective, in: A&NZ Mar LJ 22 (2008), 22.

54 See below *sub* E.

55 See generally *Ernest Lorenzen*, The Pan-American Code of Private International Law, in: Tulane Law Review 4 (1930), 499 ss.

general principle. However, on 3 February 2016, a Sao Paulo Appeals Court held that Nordic Trustee's Liberian ship mortgage would not be recognised as a valid mortgage in the Brazilian proceedings, and this judgment was upheld in an appellate decision of 01 June 2016. The court argued that ship mortgages registered under a foreign law would be regarded as effective only if there was a binding treaty between Brazil and the flag law State concerning the reciprocal recognition of ship mortgages or if there was shown to be international customary law that recognises the validity of the foreign mortgage in Brazil. The court held that the fact that Brazil is a party to the 1926 Brussels Convention and to the Bustamante Code is not relevant since Liberia is not a signatory to either of these Conventions and therefore reciprocity is not ensured. As regards the existence of a rule of international customary law providing for the recognition of ship mortgages under a foreign law of the flag, the court held that there was not sufficient evidence for the existence of such a rule.

This decision is a cause for immense concern for secured creditors since the recognition and status of ship mortgages under a foreign law of the flag now must be regarded as being no longer secured whenever a ship is in Brazilian waters, unless the flag State is a party to the 1926 Convention or the Bustamante Code. It has been suggested that vessels currently registered in Liberia could be re-flagged to Panama which is a party to the Bustamante Code in order to ensure the recognition of ship mortgages registered under the law of the flag in Brazil.[56] This solution, however, would obviously cause considerable costs and may not be feasible in every case,[57] especially in view of the fact that the choice of register for a ship also governs the safety regulations, labour laws and other rules under which the ship is operated.[58]

The decision in the OSX-3 case is a strong reminder that, at least in the absence of clear statutory provisions on the recognition of foreign maritime security rights, courts may deny the validity and effectiveness of ship mortgages and hypothecations under a foreign law of the flag even in jurisdictions that previously were understood as following the principle of the application of the rule of the law of the flag as regards the recognition of ship mortgages and hypothecations under a foreign law. If this decision is not reversed by the Superior Tribunal de Justiça, a similar reasoning could arguably even be applied in other Latin American jurisdictions that are party to the Bustamante Code.

II. Priority of consensual proprietary security over ships

Apart from the question of the recognition of foreign ship mortgages and hypothecs, there is also a need for certainty as regards the priority status of competing consensual proprietary security rights over ships in cross-border transactions. The value of a ship mortgage or hypothecation as a proprietary security for the secured creditor´s claim is obviously to a large extent determined by its priority status: Even where there are no doubts as to the recognition of a proprietary security over a vessel, a secured creditor who has advanced credit in reliance on this interest might effectively be deprived of its security where a competent court subsequently holds that under the applicable rules of priority a competing security right under another law takes precedence over that interest. As regards the issue of the priority status of

[56] See the suggestions in the law blog operated by the law firm CMS legal: http://www.cms-lawnow.com/ealerts/2016/06/ship-mortgages-in-brazil--continuing-uncertainty-for-secured-creditors.

[57] See generally *Dmitri Pentsov*, Maritime Liens, Rights of Retention, and Mortgage of Vessels under the Legislation of the Russian Federation, in: Tulane Maritime Law Journal 26 (2002), 609.

[58] *Cf*. the duties of the flag State under the United Nations Convention on the Law of the Sea of 1982, Article 94.

consensual proprietary security rights over ships in a cross-border situation, secured creditors face the double problem that there are still considerable differences as regards the rules on priority of consensual proprietary security over ships under the various jurisdictions world-wide[59] and that there is no international consensus on the determination of the applicable law for these issues of priority.[60]

1. Differences in the rules on priority of consensual proprietary security over ships

To the extent that national law provides for the registration of consensual proprietary security over ships such as ship mortgages or hypothecations in a national register,[61] most legal systems are in agreement that as a general starting point, the order of priority as between such registered security rights is to be determined according to the order of registration.[62] However, this general rule is subject to several exceptions where there is no unanimity among the various jurisdictions world-wide:

Firstly, some details of the priority rules concerning consensual security over ships vary as between different legal systems. Some legal systems, for example, provide that rights registered at the same date have equal ranking.[63] In other legal systems, the order of priority is determined by the order of registration, giving rights registered at the same date, but before other rights, priority over the latter.[64] Another issue concerns forms of provisional or advance registration: Such measures are allowed in some legal systems, but there is, for example, no unanimity as to the length of the period of time for which a priority position can be secured under such a registration.[65]

Secondly, some legal systems provide that regardless of the order of registration, consensual security interests acquired by a secured creditor which knew or should have known of the existence of earlier security interests cannot take priority over those earlier security interests.[66]

Thirdly and most importantly, some legal systems have specific priority rules under which foreign consensual security interests over ships are generally treated less favourably than domestic security rights. The non-recognition of foreign security rights which has been dealt with in the preceding section is obviously the most evident case of a disadvantageous treatment of foreign security rights. Other legal systems, however, do not regard foreign ship mortgages or hypothecations as ineffective, but assign them to a lower priority position than domestic security rights: A prime example is United States law, where foreign ship mortgages enjoy the same ranking as equivalent domestic interests (*i.e.,* Unites States

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59 See below *sub* D.II.1.

60 See below *sub* D.II.2.

61 See the references below *sub* D.III.1.

62 Cf. the endorsement of this principle in the UNCITRAL Legislative Guide on Secured Transactions (2007), Chapter IV, para. 3 (p. 149); see also *Ulrich Drobnig and Ole Böger,* Proprietary Security in Movable Assets (PEL Prop. Sec.), Sellier and Oxford University Press 2015, at 457.

63 See Sweden: *Sjölag* 1994 (Maritime Code), Chap. 3, Section 12; see also Norway: *Lov om sjøfarten* 1994 (Maritime Code), Section 23(2).

64 See Argentina: *Ley* no. 20.094/1974 *Régimen de navegación* (Shipping Act), Article 504; England: Merchant Shipping Act 1995, sch. 1, para. 8(1); Germany: *Schiffsregistergesetz* (Ship Register Act), § 25(1); New Zealand: Ship Registration Act 1992, Section 40(1).

65 See England: the Merchant Shipping (Registration of Ships) Regulations 1993, Reg. 59, allows the registration of a (renewable) notice by an intending mortgagee which has the effect of securing the priority position if the mortgage is registered within 30 days; under the law of Panama, such a priority position can be secured for 6 months, see *Ley del Comercio Maritimo* 2008 (Maritime Commerce Act), Article 252.

66 See Norway: *Lov om sjøfarten* 1994 (Maritime Code), Section 24(1).

preferred ship mortgages) only if they are guaranteed under the Federal Ship Financing Program.[67]

2. Divergent conflict-of-laws rules on priority of consensual proprietary security over ships

Given these differences among the legal systems world-wide as to the rules on the priority status of competing consensual proprietary security rights over ships, it would be very much in the interest of secured creditors holding such security interests in cross-border situations if there was at least no lingering uncertainty as to the determination of the legal regime under which the priority position of the security interest is to be decided. However, there is no such unanimity and the various legal systems world-wide appear to be divided in two groups following two opposite approaches on this issue. Many legal systems apply the same conflict-of laws rule that predominantly determines the status of consensual proprietary security over ships, *i.e.*, they decide issues of priority as between consensual security over ships according to the law of the flag.[68] Other jurisdictions, however, do not share this view. Emphasising the procedural role of the determination of priority in the process of enforcing security rights, the law of the forum is applied and there is no submission to the application of any foreign law of the flag.[69] While the former conflict-of-laws rule can at least provide some certainty and predictability for the secured creditor as regards the applicable regime for the determination of the priority status as between consensual security rights, the rule on the application of the law of the forum has the effect that it cannot be predicted at the moment of the conclusion of the security agreement which priority rules will be applied in an eventual dispute which might be brought before a foreign court exercising jurisdiction over the vessel on the basis of the arrest of the ship at its current location.

III. Issues concerning the requirements of registration in registers under national law

Current international legal thinking on the law of proprietary security puts a strong emphasis on the existence of a system of registration that provides publicity for the existence of consensual proprietary security rights.[70] Secured creditors shall be able to make their

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[67] Title XI of the Merchant Marine Act 1936, see 46 USC Chapter 537 and 46 USC Section 31326(b)(2); *William Tetley*, Arrest, Attachment, and Related Maritime Law Procedures, in: Tulane Law Review 73 (1999), 1895, at 1931; *Alexandra Mandaraka-Sheppard*, Modern Maritime Law, Volume 1, Informa 2013, at 190.

[68] See, for instance, Norway: *Lov om sjøfarten* 1994 (Maritime Code), Section 75(2) no. 1; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), Article 45(1) Nr. 2; *Karl Kreuzer*, Die Vollendung der Kodifikation des deutschen Internationalen Privatrechts, in: Rabels Zeitschrift für ausländisches und internationales Privatrecht 65 (2001), 383, at 455; for a contrary view see *Christiane Wendehorst*, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, ed. 5, Beck 2010, Art. 45 EGBGB para. 81, arguing that the law of the location of the ship, which is decisive for determining the priority status of non-consensual security rights (see *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), Article 45(2) sent. 2 *juncto* Article 43(1), should also govern the priority status of consensual security rights in order to avoid conflicts that might otherwise arise in the event of two different priority regimes being applied in situations where there are several non-consensual and consensual security rights. For similar concerns under Greek law see *Sotiropoulos*, (*op. cit.* fn. 6), at 314.

[69] See, for instance, Argentina: *Ley* no. 20.094/1974 *Régimen de navegación* (Shipping Act), Article 600 (under the condition that the reciprocity requirement is fulfilled and the foreign interest is recognised in Argentina); Canada: *Todd Shipyards Corp v Altema Compania Maritima SA (The Ioannis Daskalelis*) [1974] SCR 1248; England: *The Colorado* [1923] P. 102; Greece: see the case law referenced by *Sotiropoulos*, (*op. cit.* fn. 6), at 312; New Zealand: Ship Registration Act 1992, Section 70. This approach is also favoured in the general treatise by *Carbone* (*op. cit.* fn. 45), at 255 s.

[70] See UNCITRAL Legislative Guide on Secured Transactions (2007), Chapter IV, paras. 1 and 29 (pp. 103, 110); *Drobnig and Böger* (*op. cit.* fn. 62), at 433.

security interests known to the public and prospective secured creditors and buyers shall be able to rely on the content of a public register as regards the existence of prior security rights, protecting them against the risk of the existence of silent security rights that would take precedence over any proprietary interests to be acquired by the prospective secured creditors and buyers. At the same time, a system of publicity by registration should not operate unduly burdensome: An efficient system of registration should allow for a simple and reliable way of obtaining information about existing security rights and there should be clear and simple requirements for the registration process, which in turn should lead to a decrease in the amount of costs and effort required and to a reduction of the risk of an inadvertent failure to comply with registration requirements. Presently, the legal situation as regards publicity requirements for ship mortgages and hypothecations in cross-border situations does not entirely fulfil either of these requirements.

1. Registration of ship mortgages and hypothecations in ship registers under national law

Under most national legal systems, ship mortgages and hypothecations can become effective against third parties in general (often referred to as perfection of the security)[71] only upon fulfilment of a requirement of publicity, usually by means of registration.[72] Such a registration of consensual proprietary security interests over ships usually takes place in the title register for the vessel concerned, *i.e.,* a ship register under national law[73] (whether a national ship register[74] or an open register[75]). A search of such an asset-based register should retrieve all registered information concerning each individual vessel, especially on the identity of the owner and on all registered consensual security rights such as ship mortgages or hypothecations over this vessel. A notable exception is the English equitable mortgage over ships which does not require registration under the Merchant Shipping Act 1995, but whose low priority status severely restricts its value as a security right;[76] moreover, especially for smaller ships, there is often an exemption from the requirement of registration of the ship and of any security rights created over it.[77]

Still, even though registration is the norm for ship mortgages and hypothecations world-wide, the process of obtaining reliable information for prospective secured creditors and buyers as regards the existence of prior security rights may especially in a cross-border context still be rather cumbersome: Interested parties may have to contact a ship register operated under

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71 See generally *Drobnig and Böger* (*op. cit.* fn. 62), at 397; for US-American law see Uniform Commercial Code (UCC) Sections 9-301 ss.

72 See generally *Wood*, Security and Title Finance (*op. cit.* fn. 43), para. 28-009.

73 See, for instance, England: Merchant Shipping Act 1995, sch. 1, para. 7; France: *Pierre Bonassies and Christian Scapel*, Droit Maritime, ed. 2, L.G.D.J. 2010, at 385; *Philippe Simler and Philippe Delebecque*, Les sûretés, ed. 6, Dalloz 2012, at 657; Germany: *Schiffsregistergesetz* (Ship Register Act), §§ 8 and 3; Turkey: *Kerim Atamer*, New Turkish Law on Ship Finance, in: Orestis Schinas, Carsten Grau and Max Johns (eds.), HSBA Handbook on Ship Finance, Springer 2013, 201, at 206; United States: 46 USC Section 31321(a)(1).

74 *I.e.,* a ship register under national law that is restricted to domestically-owned ships. Increasingly, States operate two ship registers, the second (or international) ship register applying no restrictions on the nationality of the crew and lower safety standards compared to the first register and not necessarily being restricted to domestically-owned ships, see, for instance, Germany: §§ 2 and 12 Flaggenrechtsgesetz (German Flag Act); Norway: *Robert Kappel*, The Norwegian international ship register, Bremen Institute of Shipping Economics and Logistics 1988.

75 *I.e.,* a ship register under national law that allows the registration of foreign-owned ships (subject to the existence of a requirement of a "genuine link" as prescribed by the 1958 Geneva Convention on the High Seas, Article 5). The main examples of such ship registers under a "flag of convenience" are the ship registers of Panama, Liberia and the Marshall Islands.

76 See, generally, *Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomicka* The law of security and title-based financing, ed. 2, Oxford University Press 2012, para. 14.37.

77 See for English law *Beale, Bridge, Gullifer and Lomnicka* (preceding fn.), para. 14.34.

foreign domestic law, sometimes there are several ship registers in the flag State[78] and the transition from a traditional paper-based register to electronically accessible registers sometimes is not yet fully completed.[79]

2. Differences concerning registration requirements and procedures under national law

The current lack of a harmonised electronically accessible registration system for consensual proprietary security rights over ships does not only make it less easy to obtain reliable information on the existence of ship mortgages and hypothecations over foreign vessels. The fact that the formal requirements to be fulfilled in order to effect the registration of a proprietary security interest over a ship vary according to the jurisdiction concerned[80] also adds additional complications to the registration process itself. A secured creditor intending to register its security rights in foreign registers will have to follow different registration procedures for each register concerned, which is likely to make it necessary to seek local legal advice for each different registration process: While some jurisdictions require either notarisation of the security agreement or mortgage deed[81] or attestation of the shipowner's signature,[82] other jurisdictions insist on the use of prescribed forms.[83] Moreover, the different national legal systems allow the application for registration to be made at different places, especially as regards the possibility of effecting a registration outside the territory of the flag State. While some jurisdictions allow applications for registration at any foreign consulate of the flag State,[84] others restrict such possibilities to certain consulates in the most important port cities.[85] Moreover, in addition to publicity by registration, some legal systems require a copy of the mortgage document to be kept on board the ship as an additional formal requirement,[86] but failure to comply with this requirement does not necessarily invalidate the mortgage.

3. Security over ships and the registration in general debtor-indexed registers

Registration of proprietary security rights over ships is further complicated by the fact that in many legal systems there is not only an asset-specific ship register, but also a general debtor-indexed register for proprietary security, *i.e.,* a register that is organised according to the name or other identifier of the security provider and that covers all (or at least most) types of consensual security rights in movable property. The classical examples of such debtor-

78 Germany: *Schiffregisterordnung* (Ship Register Order), §§ 1 and 4.

79 See, for instance, the Irish Merchant Shipping (Registration of Ships) Act 2014, which provides for the electronic operation of the ship register, but which will come into operation only at the date still to be appointed by order of the Minister for Transport, Tourism and Sport.

80 For a comparative treatment of the various formal requirements under the different legal systems worldwide see *Lucy French*, The Ship Mortgage, in: Stephenson Harwood (eds.), Shipping Finance, ed. 3, Euromoney Books 2006, 125-224; Hill Dickinson (eds.), International Ship Registration Requirements, available for download under www.hilldickinson.com/pdf/International%20ship%20registration%20requirements.pdf.

81 See, for instance, Greece: *Spyridon Vrelis*, Private International Law in Greece, Kluwer 2011, 118; see also the requirements under the German *Schiffsregisterordnung* (Ship Register Order), § 37(1) concerning the consent of the shipowner.

82 See the Norwegian *Lov om sjøfarten* 1994 (Maritime Code), Section 15(2).

83 See England: Merchant Shipping Act 1995, sch. 1, para. 7(2).

84 See Panama: *Ley del Comercio Maritimo* 2008 (Maritime Commerce Act), Article 250.

85 See, for instance, for Greek law *Wood*, Security and Title Finance (*op. cit.* fn. 43), para. 28-041.

86 This requirement is also prescribed by the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, Article 12.

indexed general registers for proprietary security are the English Companies Register[87] and the register of security interests under US-American UCC Article 9.[88] While there is a recognisable trend for the introduction of such registers even in legal systems that previously did not have general debtor-indexed registers for proprietary security,[89] there is still a number of legal systems without general debtor-indexed registers and where publicity by registration is required only as registration in specific asset-based registers for certain types of collateral such as ships or aircraft.[90]

In the jurisdictions with both such general debtor-indexed registers and asset-specific registers for ships, different solutions have been found to the question of how the existence of a general requirement to register all proprietary security interests in the general debtor-indexed register should affect the registration requirements for ship mortgages and hypothecs. In some legal systems, a secured creditor is only required to comply with the registration requirements concerning the asset-specific ship register, security over ships being specifically exempted from the scope of the security interests that are registrable in the general debtor-indexed register.[91] This precedence of registration in the asset-specific register over a general debtor-indexed register is also favoured by current international legal thinking on proprietary security in movables.[92] Nevertheless, the legal systems of several other important shipping jurisdictions still require proprietary security rights over ships to be registered both in the asset-specific register and in the general debtor-indexed register. In some of these legal systems, registration in the debtor-indexed register alone determines the third party effectiveness of the security in general, especially in the event of insolvency, while registration in the asset-specific register provides protection against loss of priority vis-à-vis competing security interests.[93] A few legal systems have even entirely replaced the registration of ship mortgages in the asset-specific ship register by registration in the general debtor-indexed register.[94]

IV. Different remedies under existing proprietary security rights

The typical consensual proprietary security rights over ships that are currently available to ship financiers under the various legal systems world-wide are the ship mortgage which has primarily been developed by the courts under the common law tradition[95] and the civil law ship hypothecation which has been introduced by legislation.[96] Concerning the objective of

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87 For the operation of the English Companies Register as a debtor-indexed register see *Beale, Bridge, Gullifer and Lomnicka* (*op. cit.* fn. 76), para. 10.07.

88 See US-American UCC Section 9-519(c).

89 See the references in *Drobnig and Böger* (*op. cit.* fn. 62), at 438 ss.

90 *E.g.,* Austria and Germany, see *Drobnig and Böger* (*op. cit.* fn. 62), at 444.

91 See, *e.g.*, New Zealand: Ship Registration Act 1992, Section 23 (e)(xi); US-American UCC Section 9-311 (a), exempting all assets whose encumbrances are subject to registration in an asset-specific register from registration requirements in the general debtor-indexed register. Moreover, Section 9-109 (c)(1) prevents the application of Article 9 to the extent that it is preempted by a federal statute such as the US-American Commercial Instruments and Maritime Liens Act 1988 (46 USC Chapter 313).

92 See UNCITRAL Legislative Guide on Secured Transactions (2007), recommendation 77 and Chapter III, para. 73 (p. 121): while effectiveness against third parties in general can be achieved by registration in either the general register or in the asset-specific register, the priority status vis-à-vis competing secured creditors is to be determined on the basis of the registration in the asset-specific register; *Drobnig and Böger* (*op. cit.* fn. 62), at 453.

93 See the situation in England: *Beale, Bridge, Gullifer and Lomnicka* (*op. cit.* fn. 76), paras. 14.41/45; *Wood*, Security and Title Finance (*op. cit.* fn. 43), para. 28-030.

94 In Australia, the Personal Property Securities Act 2009 has replaced the former provisions on the registered ship mortgage in the Shipping Registration Act 1981.

95 See *William Tetley*, Maritime Transportation, in: René David *et al.* (eds.), International Encyclopedia of Comparative Law, Vol. XII, chap. 4 (Mohr 1997), para. 320.

96 *Tetley*, Maritime Transportation (*op. cit.* fn. 95), para. 319; See generally *Francesco Berlingieri*, Lien holders and mortgagees: who should prevail?, in: Lloyd's Maritime and Commercial Law Quarterly 1988, 157,

entitling the secured creditor to preferential satisfaction of its claims through enforcement into the vessel, these rights can be regarded as being functional equivalents, but this diversity of the types of security interests that is due to reasons of legal history[97] still results in the availability of different remedies for the secured creditor in the various jurisdictions.

The holder of a ship mortgage under common law legal systems traditionally has a stronger position in relation to the enforcement of its rights. Upon default, the mortgagee can exercise a right to possession of the ship, exercise control over the ship and enjoy its earnings (while also being liable for expenses)[98] and satisfy the secured claim out of the proceeds of an out-of-court sale of the ship.[99]

The holder of a ship hypothecation under a civil law system, on the other hand, can traditionally exercise its rights only through judicial enforcement, typically by way of a judicial sale. [100] To some extent, however, these differences can be overcome by parties contractually providing for a power of sale for the creditor, which has been reported as being common in the market practice.[101] Moreover, in several civil law systems specific legislation has been enacted in order to grant the holder of a ship hypothecation such rights as are available to the mortgagee of a ship.[102]

V. Issues regarding conflicts with non-consensual maritime liens

Apart from the legal risks arising in relation to the publicity, recognition, priority and enforcement of consensual maritime proprietary security rights in a cross-border context, ship financiers face additional risks in relation to competing non-consensual proprietary security rights over ships, *i.e.,* maritime liens. In certain situations, such maritime liens can take precedence even over earlier consensual maritime proprietary security rights, thereby effectively depriving the holder of the latter of its protection in the insolvency of the debtor. The laws of the different shipping jurisdictions as regards the scope and priority status of maritime liens differ widely and efforts for legal harmonisation have been largely futile so far. This makes things even worse for the holders of consensual security rights over ships: Whether and to what extent in a potential dispute their security rights might be held by a competent court to be negatively affected by maritime liens often depends upon the place where the ship is located at that particular moment or upon the choice of forum by the claimant (for which the location of the ship will also be a deciding factor), *i.e.,* factors that are to some extent subject to chance and cannot be predicted in advance.

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at 162; *John Kriz*, Ship Mortgages, Maritime Liens and their Enforcement, in: Duke Law Journal 1963, 671, at 677 (at fn. 26).

97 For a more detailed description see *Böger* (*op. cit.* fn. 6), at 29.

98 See for English law *Beale, Bridge, Gullifer and Lomnicka* (*op. cit.* fn. 76), para. 18.37.

99 See, *e.g.*, the Australia: Personal Property Securities Act 2009, Section 128 (2) (the same remedy was available under the former Shipping Registration Act 1981, Section 41).

100 See, for Argentina the references in Lennart Hagberg (ed.), Handbook on Maritime Law, Vol. III (Kluwer 1983), at 10; Germany: *Schiffsregistergesetz* (Ship Register Act), § 47; see generally on this distinction *Giorgio Filippi*, I diritti reali di garanzia sulla nave nell'ambito del diritto materiale uniforme, in: Scritti in Onore di Francesco Berlingieri, Diritto Maritimo 112 (2010), Vol. 1, 485, at 510; *Alexandra Mandaraka-Sheppard*, Modern Maritime Law, Volume 1, Informa 2013, at 178.

101 See *Filippi*, preceding footnote, at 512.

102 See, for instance, the preferred consensual security over ships under Greek Legal Decree 3899 of 1958; *Sotiropoulos*, (*op. cit.* fn. 6), at 307.

1. Maritime liens in general

A maritime lien is a proprietary security interest encumbering a ship that entitles the holder of the lien as a secured creditor to preferential satisfaction of its secured claims through enforcement into the ship.[103] As a true property right that also may be enforced against subsequent owners of the ship, the maritime lien should be distinguished from a merely procedural remedy in the form of a statutory right of action in rem,[104] which under the British and some Commonwealth national legal systems gives the beneficiary the right to arrest a ship as security for the satisfaction of certain maritime claims against the shipowner,[105] but which generally ranks below any other proprietary interest in the ship.[106]

Maritime liens are different from consensual maritime proprietary security rights such as the ship mortgage or hypothecation in that they arise by operation of law without the need for the conclusion of a security agreement between the parties to this effect.[107] This includes that the general publicity requirements for consensual proprietary security over movables do not apply,[108] *i.e.,* there is no registration requirement and silent security interests are effective against other creditors including the holders of competing ship mortgages or hypothecs.

Instead, maritime liens automatically arise whenever there is a claim that is covered by the list of qualifying maritime claims in the relevant jurisdiction. There are, however, considerable differences as between the various legal systems concerning these lists of qualifying maritime claims that give rise to a maritime lien:[109] Concerning situations such as claims for wages, there is widespread agreement that such claims deserve to be secured through an *ex lege* security right.[110] In other cases, however, there is no such unanimity, a main area of dispute being claims for necessaries, *i.e.*, bunkers, supplies, repairs, and towage, as well as claims for cargo damage and general average.[111]

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103 *Tetley*, Maritime Transportation (*op. cit.* fn. 95), para. 313; *Ivon d'Almeida Pires Filho*, Comparative Maritime Liens, in: Maritime Lawyer 9 (1984), 245.

104 *Tetley*, Arrest, Attachment (*op. cit.* fn. 67), at 1910 s.; *Tetley*, Maritime Transportation (*op. cit.* fn. 95), para. 314.

105 *Tetley*, Maritime Transportation (*op. cit.* fn. 95), para. 314.

106 *Tetley*, Arrest, Attachment (*op. cit.* fn. 67), at 1911.

107 See Germany: *Handelsgesetzbuch* (Commercial Code), sec. 597; Greece: *Sotiropoulos*, (*op. cit.* fn. 6), 299; United States: *Cardinal Shipping Corp v M/S Seisho Maru*, 744 F.2d 461, at 466 (United States Court of Appeals, Fifth Circuit, 1984); see also *Tetley*, Maritime Liens, Mortgages and Conflict of Laws (*op. cit.* fn. 52), at 5.

108 *Tetley*, Arrest, Attachment (*op. cit.* fn. 67), at 1909 s.

109 For English law see the list of maritime liens referred to in *The Ripon City* [1897] P. 226, at 241 s.; *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221, at 232 (PC); France: *Code des transports* (Transport Code), Article L5114-8; Germany: *Handelsgesetzbuch* (Commercial Code), §§ 596 s; Greece: Code of Private Maritime Law of 1958, Article 205; *Sotiropoulos*, (*op. cit.* fn. 6), at 307; United States: 46 USC Section 31301(4) and (5), see *Delos Flint*, Current Developments in United States Maritime Lien Law, in: University of San Francisco Maritime Law Journal 8 (1996), 267, at 269 ss. For an overview over the law of maritime liens in Latin America see *Pires Filho*, (*op. cit.* fn. 103), at 245 ss.

110 For England, see *The Ripon City* [1897] P. 226, at 242; Germany: *Handelsgesetzbuch* (Commercial Code), § 596; Italy: *Codice della Navigazione* (Maritime Act), Article 563; United States: 46 USC Sections 31301(5)(D), 31342(a)(1).

111 Such claims are secured by maritime liens, for instance, in the United States, see 46 USC Sections 31301(4) and (5)(B), 31342(a)(1), and France, see *Code des transports* Article L5114-8, whereas under English law, there is no such protection for these types of claim, see the restricted list in *The Ripon City* [1897] P. 226, at 242; *Beale, Bridge, Gullifer and Lomnicka* (*op. cit.* fn. 76), para. 6.166. For a comparison of various legal systems in this respect see *Berlingieri*, Lien holders and mortgagees (*op. cit.* fn. 96), at 158 ss.; *Tetley*, Maritime Transportation (*op. cit.* fn. 95), paras. 313 ss.

2. Priority status of maritime liens

Maritime liens are subject to specific rules on priority that differ from the typical rules on the order of priority that apply to proprietary security rights in general, including ship mortgages and hypothecs. The general rule on the order of priority of competing proprietary security rights that appears to be universally accepted is that the first in time prevails, regardless of the types of proprietary interests involved.[112] The priority status of maritime liens, however, however, varies considerably between the various national legal systems.

Primarily, the ranking of maritime liens depends upon the type of maritime claim secured by the lien, *i.e.,* maritime liens securing certain types of claims taking precedence over other maritime liens under national law (with differing orders of precedence in the different jurisdictions).[113] Moreover, even maritime liens for claims of the same type typically do not rank according to the order of time: Instead, they are either regarded as all having the same priority position, regardless of which lien arose first,[114] or there may even a reversal of the usual order of priority, *i.e.,* subsequent maritime liens take priority over maritime liens for earlier claims.[115] While this might at first appear surprising from the point of view of secured transactions law in general, such a preferred priority position of the latest maritime liens can at least as regards certain maritime claims for remuneration for services performed for the benefit of the ship in principle be based upon the reasoning that the it is, *e.g.*, the last provider of repairs or supplies who keeps the ship on its venture and thereby allows it to earn freight, which is in the interests of all creditors.[116]

These specific priority rules for maritime liens also affect the priority position of holders of consensual maritime proprietary security rights such as ship mortgages or hypothecs: Also these security rights have to give precedence to all[117] or at least some[118] types of maritime liens recognised under the relevant national law, even if these liens are not registered and therefore not visible from any register or if they arise only after the creation of the ship mortgage or hypothec. Effectively, a maritime lien that takes precedence over a ship mortgage or hypothecation may entirely deprive the holder of the latter of its security,

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112 Cf. the endorsement of this principle in the UNCITRAL Legislative Guide on Secured Transactions (2007), recommendation 76(a) and Chapter V, para. 46 (p. 196 s.); *Drobnig and Böger* (*op. cit.* fn. 62), at 556.

113 See Germany: *Handelsgesetzbuch* (Commercial Code), § 603(1); Italy: *Codice della Navigazione* (Maritime Act), Article 563(1).

114 See, for example, Germany: *Handelsgesetzbuch* (Commercial Code), § 604(1).

115 See, for instance, for English law *Tetley*, Maritime Transportation (*op. cit.* fn. 95), para. 335; for United States law *The John G. Stevens*, 170 U.S. 113, at 119 (Supreme Court, 1898); under German and Italian law, this reversal of the usual order of priorities applies as provided for under the German *Handelsgesetzbuch* (Commercial Code), §§ 596 s., 604(3) and the Italian *Codice della Navigazione* (Maritime Act), Article 563(2), respectively. This principle has also been acknowledged by the international conventions in this field of law, which will be dealt with in more detail below *sub* E, see the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, Article 6 sent. 2, the 1967 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, Article 5(4), and the 1993 Geneva Convention on Maritime Liens and Mortgages, Article 5(4).

116 See generally *Richard Gyory*, Security at Sea: A Review of the Preferred Ship Mortgage, in: Fordham Law Review 31 (1962), 231, at 258; *Tetley*, Maritime Transportation (*op. cit.* fn. 95), paras. 333 ss.

117 See, for example, Germany: *Handelsgesetzbuch* (Commercial Code), § 603; China: all maritime liens have priority over ship mortgages, Article 25 of the Chinese Maritime Code of 1993, see *Herbert Lord*, The new Chinese Maritime Code, in: International Business Law Journal 1997, 924 s, including earlier mortgages, see *Donglai Yang*, A Comparative Analysis of Maritime Lien Priority under United States and Chinese Maritime Law, in: Tulane Law Journal 23 (1999), 465, at 468.

118 Argentina: *Ley* no. 20.094/1974 *Régimen de navegación* (Shipping Act), Article 476; France: all privileged maritime liens enjoy priority over consensual proprietary security rights in the ship, see *Code des transports* Article L5114-13, whereas privileges under the general law rank behind all ship mortgages, see Article L5114-14. For a comparative summary of United Kingdom and the United States law see *William Tetley*, Maritime Liens in the Conflict of Laws, in: James Nafziger and Symeon Symeonides (eds.), Law and Justice in a Multistate World: Essays in Honor of Arthur T. von Mehren, Ardsley 2002, 439-457.

especially in situations where the maritime claim underlying the maritime lien is for a substantial amount of money and does not necessarily correspond to the provision of services that benefit the value of the ship, *e.g.,* in cases of maritime claims for damages. The extent to which the position of the holder of a ship mortgage or hypothecation faces the risk of being negatively affected by higher-ranking maritime liens depends upon both the scope of the list of maritime liens under the relevant national law and this law´s rules on the priority status of those maritime liens. These rules reflect general policy decisions of legal systems concerned, favouring either the ship financing business (by protecting the priority status of ship mortgages or hypothecs) or the maritime service industry (by extending the scope of maritime liens) and these issues have proved to be highly contentious in past attempts to harmonise the law of proprietary security interests over ships that covered maritime liens as well.[119]

3. Conflict-of-laws rules regarding maritime liens

The legal risks faced by holders of ship mortgages or hypothecations as regards competing maritime liens are further exacerbated by the fact that the determination of the applicable law governing maritime liens and their priority status adds additional uncertainties to this issue. Also the conflict-of-laws rules applied under the various legal systems worldwide vary significantly in this regard and there are at least three main approaches concerning the governing law for maritime liens and their priority status:[120] firstly, a general reference of the law of forum State, based upon the idea that maritime liens are argued to be primarily of a procedural character;[121] second, the application of the *lex causae* of the maritime claim underlying the maritime lien, *i.e.*, the law that is applicable to the claim that is secured by this non-possessory security, for the issue of the existence of the maritime lien,[122] coupled with an application of the law of the forum as regards the determination of the priority status of the maritime liens amongst competing security interests (in order to avoid problems that would otherwise arise where there are several maritime liens arising under different governing laws);[123] third, the application of the law of the flag for issues of maritime liens,[124] even though especially in cases of the use of flags of convenience there will often be no

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119 *Cf. Francesco Berlingieri*, The 1993 Convention on Maritime Liens and Mortgages, in: Lloyd's Maritime and Commercial Law Quarterly 1995, at 57; Lord *Diplock*, in *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221, at 232 (PC); see also the repeated attempts to achieve international harmonisation through amendments and revisions of the catalogue of maritime liens and their priority under the various international instruments in this field, see below *sub* E.

120 For a more detailed description see *Malcolm Clarke*, Transport by Sea and Inland Waterways, in: René David *et al.* (eds.), International Encyclopedia of Comparative Law, Vol. III, chap. 26 (Mohr 1994), paras. 62 ss.

121 See, *e.g.*, Australia: *Morlines Maritime Agency Ltd v the Proceeds of Sale of the Ship Skulptor Vuchetich* [1997] FCA 1627; China: Maritime Code of 1993, Article 272; England: *Bankers Trust International Ltd v Todd Shipyards Corp (The Halcyon Isle)* [1981] AC 221 (PC); *Oceanconnect UK Ltd v Angara Maritime Ltd* [2010] EWCA Civ 1050, at para. 39 (CA); France: *Bonassies and Scapel* (*op. cit.* fn. 73), at 406.

122 See, for instance, Canada: *Todd Shipyards Corp v Altema Compania Maritima SA (The Ioannis Daskalelis*) [1974] SCR 1248; Germany: *Einführungsgesetz zum Bürgerlichen Gesetzbuch* (Introductory Law to the Civil Code), Article 45(2) sent. 1; United States: *Dresdner Bank AG v MV Olympia Voyager* 463 F3d 1210 (11th Cir 2006).

123 See, for instance, Canada: *Todd Shipyards Corp v Altema Compania Maritima SA (The Ioannis Daskalelis*) [1974] SCR 1248; United States: *The Scotia,* 35 F. 907, 911 (S.D.N.Y. 1888); *Martin Davies*, Choice of Law and U.S. Maritime Liens, in: Tulane Law Review 83 (2009), 1435, at 1457 s.; *Tetley*, Maritime Liens, Mortgages and Conflict of Laws (*op. cit.* fn. 52), at 15.

124 See, *e.g.*, Greece: *Vrelis* (*op. cit.* fn. 81), at 118; Italy: *Codice della Navigazione* (Maritime Act), Article 6; *Guido Ferrarini*, Foreign law mortgages, hypotheques and charges in Italy, in: Journal of International Banking Law 6 (1999), 191, at 194.

substantial connection between the law of the flag and the circumstances that give rise to a claim secured by a maritime lien.[125]

E. Existing international instruments on proprietary security over ships and their lack of success

There have been repeated attempts to solve the problems encountered in relation to the divergent national legal regimes on proprietary security over ships through the preparation and adoption of international instruments on these issues. The first to be mentioned here is the 1926 Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages that was prepared by the Comité Maritime International. This Convention was later meant to be replaced by the Brussels Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages of 1967 which, however, never entered into force. The most recent harmonisation effort in this regard was undertaken with the Geneva Convention on Maritime Liens and Mortgages of 1993 that was supported by the International Maritime Organisation and the United Nations Conference on Trade and Development. As has been pointed out above, the fact that this instrument had been adopted only shortly before was a major factor influencing the decision no longer to include ships in the early drafting stages of the Cape Town Convention in the mid-1990s.

All these three international instruments on proprietary security over ships follow an approach that is markedly different from the Cape Town Convention system in a number of respects: As regards the issue of consensual proprietary security interests in ships in a cross-border context, unlike the Cape Town Convention the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention do not provide for the creation of an international interest. Instead, they follow a conflicts-of-laws approach concerning the recognition of foreign ship mortgages and hypothecs, providing that mortgages and hypothecations must be recognised if they are effected and registered in accordance with the requirements of the law of the flag.[126] The procedures and requirements for the registration of ship mortgages and hypothecations are not harmonised and are generally left to the law of the flag State instead.[127]

There is also no uniform regime for the enforcement or priority status of consensual security rights under the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention and also here these Conventions follow a conflicts-of-laws approach instead: Enforcement is generally regarded as an issue to be decided to the law of the forum,[128] while the priority status of consensual security rights is another issue that is referred to the law of the flag.[129]

Finally, the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention do not only address the issue of consensual proprietary security rights, but did also attempt to achieve a common position as regards non-consensual proprietary security rights over ships,

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125 See *Tetley*, Maritime Liens in the Conflict of Laws (*op. cit.* fn. 118), at 455 s.; *Tetley*, Maritime Liens, Mortgages and Conflict of Laws (*op. cit.* fn. 52), at 45.

126 See Article 1 of the 1926 Brussels Convention, Article 1(a) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

127 The only exception being the – slightly differing – requirements in Article 1(c) of the 1967 Brussels Convention and the 1993 Geneva Convention concerning the naming of the secured creditor in the register or in documents deposited with the register (unless the security is to bearer) and concerning the specification of the the amount to be secured or maximum amount of the security.

128 See Article 16 of the 1926 Brussels Convention; Article 2, last half-sentence of the 1967 Brussels Convention and of the 1993 Geneva Convention.

129 See Article 2 of the 1967 Brussels Convention and of the 1993 Geneva Convention. The 1926 Brussels Convention did not regulate the priority status of consensual proprietary security rights *inter se*.

i.e., maritime liens. Each of these Conventions contains a list of recognised maritime liens[130] and provides both for their priority status inter se[131] as well as for the general preference of these liens over consensual security rights such as ship mortgages and hypothecations.[132] The main differences between the three Conventions in this respect concern the scope of maritime liens:[133] While the 1926 Brussels Convention provided that claims for expenses incurred for the preservation of the vessel should be secured by a maritime lien,[134] this item is no longer included in the list of maritime liens in the 1967 Brussels Convention and the 1993 Geneva Convention. The 1967 Brussels Convention introduced an option for the Contracting States to provide for a maritime lien for claims for repairs of a ship, which could be given priority over registered proprietary security rights, but which would be extinguished once the repairer was no longer in possession of the ship.[135] Under the 1993 Geneva Convention, however, the priority of such maritime liens for repair claims under national law was downgraded and they do no longer rank before registered consensual security interests.[136] Moreover, the 1993 Geneva Convention provided for the downgrading of maritime liens for port dues and similar claims vis-à-vis other maritime liens[137] and for the exclusion of maritime liens for oil pollution damage.[138]

While the 1926 Brussels Convention attracted 28 States Parties in total, it generally failed to gain support among the most important shipping nations world-wide.[139] The 1967 Brussels Convention was ratified only by three States[140] and never entered into force since it did not meet the required number of five States Parties.[141] The drafting and adoption of the 1993 Geneva Convention was motivated by what was widely regarded as a failure by the 1926 and 1967 Brussels Conventions to attract widespread support,[142] but in the end the 1993 Geneva Convention was even less successful with only 18 States Parties.[143]

Arguably the most decisive factor for the lack of success of these three Conventions was the fact that it proved to be impossible to reach a satisfactory compromise position on the issues of maritime liens, their scope and their priority status vis-à-vis consensual ship mortgages and hypothecations. It has to be noted that there is a strong divergence of interests between States where the focus of the economic activity as regards shipping is the financing the construction and purchase of ships (which argues in favour of giving precedence to the interests of mortgage creditors) and States whose maritime industry focusses on the

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130 See Article 2 of the 1926 Brussels Convention; Article 4(1) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

131 See Articles 5 and 6 of the 1926 Brussels Convention; Article 5(2)-(4) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

132 See Article 3 of the 1926 Brussels Convention; Article 5(1) of the 1967 Brussels Convention and of the 1993 Geneva Convention.

133 For a more detailed description of these differences between the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention, see *Berlingieri*, The 1993 Convention on Maritime Liens and Mortgages (*op. cit.* fn. 119), at 62 ss.; *Alcántara* (*op. cit.* fn. 6), at 223 ss.

134 See Article 2(1).

135 Article 6(2).

136 Article 6(c), for the right of retention in such situations see Article 7.

137 Article 4(1)(d).

138 Article 4(2).

139 The following States are Parties to the 1926 Brussels Convention: Algeria, Argentina, Belgium, Brazil, Cuba, Denmark, Estonia, Finland, France, Haiti, Hungary, Iran, Italy, Lebanon, Luxembourg, Madagascar, Monaco, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Syria, Turkey, Uruguay, Zaire. Denmark, Finland, Norway and Sweden have declared their denunciation of the 1926 Convention. Source: http://www.comitemaritime.org/Uploads/pdf/CMI-SRMC.pdf.

140 Denmark, Norway and Sweden, see http://www.comitemaritime.org/Uploads/pdf/CMI-SRMC.pdf.

141 Article 19(1).

142 Cf. *Lief Bleyen*, Judicial Sale of Ships: A Comparative Study, Springer 2015, at 12 s.

143 The following States are Parties to the 1993 Geneva Convention: Albania, Benin, Congo, Ecuador, Estonia, Lithuania, Monaco, Nigeria, Peru, Russian Federation, Serbia, Spain, St. Kitts and Nevis, St. Vincent and the Grenadines, Syria, Tunisia, Ukraine, Vanuatu.
See https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XI-D-4&chapter=11&clang=_en.

maritime service industry (which argues in favour of protecting a broad class of maritime lienholders).[144] This dilemma has not been solved by the 1993 Geneva Convention, as is confirmed by the low number of Contracting States which the Convention has been able to attract in the twenty years since its promulgation.[145]

F. How the extension of the Cape Town Convention system to ships would solve current issues concerning proprietary security over ships in a cross-border context

In the previous sections, it has been shown that the current issues concerning proprietary security over ships in a cross-border context have not been satisfactorily addressed by the existing international instruments in this field of law. This paper, however, argues that there is a case for the extension of the Cape Town Convention system to ships. This section will describe how the application of the Cape Town Convention system to ships would solve the main issues concerning proprietary security over ships in a cross-border context and which advantages the approach of the Cape Town Convention has in these respects as compared to alternative solutions.

I. Validity and effectiveness of security rights over ships under a foreign flag

As has been described above, a major concern for secured creditors as regards the use of proprietary security rights over ships in a cross-border context is that, should the ship become subject to proceedings brought by a competing creditor in a foreign jurisdiction into which the ship may have sailed in the course of its operation, the courts of the forum State might not recognise the validity of the secured creditor´s registered ship mortgage or hypothecation by reason of the fact that this security right is registered under a foreign law of the flag.[146] The application of the Cape Town Convention system to ships would protect secured creditors against this risk and an international interest under the Convention that is duly registered would be effective in any Contracting State, regardless of the forum or the flag State. Since all Contracting States and their courts would be bound by the terms of the Convention to give effect to the international interests, there would be not be a risk that the validity and effectiveness of security rights other than those registered in the domestic register could be denied. This is a marked advantage as compared to a mere (autonomous) adherence of a national legal system to the principle of the law of the flag which, as experience shows, can sometimes be reversed by domestic courts.

II. Advantages of the registration in a single international register for international interests in ships

One of the most characteristic features of the Cape Town Convention system is that it provides for a registered international interest and a single international register.[147] A requirement of publicity by registration is already a common feature for ship mortgages and

144 See *Alcántara* (*op. cit.* fn. 6), at 232.

145 See also the critical evaluation by *Alcántara* (*op. cit.* fn. 6), at 231 ss.; *Alexandra Mandaraka-Sheppard*, Modern Maritime Law and Risk Management, ed. 2, Informa 2009, at 381; *Mark Yost*, International Maritime Law & the U.S. Admiralty Lawyer, in: University of San Francisco Maritime Law Journal 7 (1995), 313, at 342 ss.

146 See above *sub* D.I.

147 Article 16; see above *sub* B.III.

hypothecations in general.[148] However, on the basis of the extension of the Cape Town Convention system to ships, the registration of ship mortgages and hypothecations in numerous different national registers would be replaced by the registration of the international interest in a single international register.

This would be greatly beneficial to the process of obtaining proprietary security over ships in a cross-border context: Secured creditors wishing to take security over a vessel under a foreign flag would no longer face the additional cost and effort of ascertaining and complying with procedural requirements for the registration of ship mortgages or hypothecations under a foreign law, depending on the relevant State of registration. This is an important advantage of the Cape Town Convention system´s uniform law approach as compared to the conflicts-of-laws approach of the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention: [149] Under the conflicts-of-laws approach, secured creditors may rely on application of the law of the flag, but the fact that the substantive content of the applicable rules concerning law will vary as between the legal systems of the various flag States creates additional burdens and legal risks for secured creditors and thereby increases the cost and reduces the availability of finance.[150]

The application of the Cape Town Convention system to ships would also solve the issue that there is no unanimity at the moment as regards the relationship between the registration of security interests over ships in asset-specific ship registers and general debtor-indexed registers under national law. [151] In cross-border transactions in particular, such double registration requirements might constitute an obstacle to the effectiveness of consensual security over ships. Under the Cape Town Convention system, however, the creation, priority status and insolvency effectiveness of registered international interests that fulfil the Convention requirements [152] is governed by international law: These provisions of an international instrument cannot be made subject to the fulfilment of requirements of national law merely by reason of the existence of a requirement under national law to register all security rights in a general debtor-indexed register. Therefore, there could no longer a need for a parallel registration of security over ships in a national debtor-indexed register.[153]

A single International Register set up under the Cape Town Convention system would also make searches for existing security interests easier: All searches could be directed to the same International Register instead of different national registers; moreover, the International Register operates electronically and allows direct, around-the-clock access for search purposes to anyone interested in its content.[154] By improving access to the register, the publicity function of registered security interests is greatly enhanced compared to that of registers operated by traditional methods and on a purely national level. To some degree, such enhanced publicity could also be achieved by improving the *modus operandi* of national registration systems. However, a unified register can only be achieved on the basis of an international instrument and the extension of the Cape Town Convention system to ships has the further advantage that the registration system under the Cape Town Convention has already been tested in practice, which serves as additional proof that existing misgivings about the electronic operation of registers of proprietary security are unjustified.

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148 See the references above *sub* D.III.1.

149 See above *sub* E.

150 See *Goode*, Priority rules (*op. cit.* fn. 1), at 95.

151 See above *sub* D.III.3.

152 See Articles 7, 29 and 30.

153 However, parties would not be prevented from continuing to register security over ships in the debtor-indexed register as well, should they wish to do so, for instance as a measure of caution in case of doubt.

154 See Article 22, see also the Regulations for the International Registry under the Cape Town Convention, regs. 3.4 and 7.

A unified register for international interests would also be of great advantage in situations of a demise charter where the vessel may under the laws of some jurisdictions be temporarily registered in a secondary register under another flag chosen by the charterer. Interests registered in the original register would not be visible for third parties through a search of the secondary register.[155] Some registers allow the secured creditors to enter a notice into the secondary register referring to a registered interest in the original register;[156] another possibility is to provide that on the ship itself there must be a notice referring to the existence of ship mortgage registered in the original register.[157] Under the operation of a unified register under the Cape Town Convention system, such difficulties could be avoided since all international interests would be registered in the unified international register.

In any case, national shipping registers would not be set aside by the introduction of an additional Protocol to the Cape Town Convention. The international registers under the Cape Town Convention system only deal with the issues covered by the Convention and its Protocols (*i.e.,* international interests and, in the case of the Aircraft Protocol[158] and the Luxembourg Protocol,[159] sales or, respectively, notices of sale), while the determination of a law of registration under a national flag would still be relevant for, amongst others, labour and safety regulations.[160]

III. A clear and uniform system of priority for consensual proprietary security over ships

The Cape Town Convention contains a uniform regime of priority as between the proprietary security interests covered by the Convention, their priority status being primarily determined by registration in the international register.[161] The application of these uniform priority rules would provide for increased predictability for market participants concerning the status of their consensual proprietary security interest vis-à-vis competing interests. Parties would no longer face the risks arising from the fact that the priority status of their proprietary security rights would follow different rules under the various national legal systems.[162] Again, this is in marked contrast with the approach of the 1967 and 1993 Conventions on Maritime Liens and Mortgages, which do not harmonise the rules on priority as between consensual security rights over ships and refer to the law of the flag instead.[163]

IV. Harmonisation of the remedies on default

Another area of law where the adoption of an additional Protocol to the Cape Town Convention has the potential of furthering the modernisation of law is the issue of remedies on default. As referred to above,[164] a distinction is traditionally made between the remedies

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155 *Lucy French*, Introduction, in: Stephenson Harwood (eds.), Shipping Finance, ed. 3, Euromoney Books 2006, at 10.

156 *French*, Introduction (see preceding fn.), at 10.

157 See for English law *Graeme Bowtle and David Osborne*, The Law of Ship Mortgages, CRC Press 2015, at 22.

158 Article III of the Aircraft Protocol.

159 Article XVII of the Luxembourg Protocol.

160 As regards aircrafts, the Dublin International Register under the Cape Town Convention system, with its registration of international interests in aircraft, exists alongside national registers in which the aircraft themselves continue to be registered for purposes of determination of nationality.

161 Article 29; see above *sub* B.III.

162 See above *sub* D.II.

163 See *Goode*, Security interests (*op. cit.* fn. 6), at 163.

164 See above *sub* D.IV.

available under a mortgage over a ship, on the one hand, and under the hypothecation of a ship, on the other hand. Such distinctions are difficult to justify from the point of view of a modern functional approach to proprietary security and they add additional complications to the position of secured creditors holding numerous security rights over ships sailing under different flags.

The Cape Town Convention for its part makes no distinction between the remedies available to a secured creditor holding an international interest (other than that of a retention of title seller or lessor).[165] The position of the secured creditor is improved by a strong emphasis on self-help remedies and by the possibility of appropriation of the encumbered asset in satisfaction of the secured claim. Still, the Convention generally acknowledges the principle of party autonomy as to the choice of available remedies[166] and also provides that remedies generally are to be exercised in conformity with the procedural provisions of the forum.[167]

V. No attempt to harmonise the law of maritime liens in general

The introduction of an additional Protocol to the Cape Town Convention covering ships would not lead to legal harmonisation as regards maritime liens. The Cape Town Convention primarily addresses only consensual proprietary security rights [168] and contains no harmonised rules on non-consensual security rights in general. This is a major point of distinction between the Cape Town Convention system and the 1926 and 1967 Brussels Conventions and the 1993 Geneva Convention: Those Conventions all included detailed harmonised rules on the creation and priority status of maritime liens, *i.e.*, non-consensual proprietary security over ships.[169]

As indicated above,[170] the various national legal systems differ widely concerning the lists of recognised maritime liens, *i.e.*, the situations which, under the various national regimes of maritime law, give rise to such maritime liens, the priority status of these non-consensual security rights and the relevant conflict-of-laws rules. It is therefore not surprising that this is an area of law where legal harmonisation was often thought to be most sorely needed, as evidenced by the repeated attempts to harmonise the law of maritime liens in 1926 and 1967 Brussels Convention and in the 1993 Geneva Convention.

Still, the fact that an additional Protocol to the Cape Town Convention covering ships would not address these issues should not be regarded as an argument against such an extension of the Cape Town Convention system. It should be borne in mind that these divergences between the various national legal systems as regards maritime liens and the fact that no broad international consensus was to be achieved so far in this respect have so far proved an insuperable obstacle to the success of major harmonisation efforts in this field of law.[171] The limited scope which a new Protocol would have in this respect may be expected to raise its chances of finding broader support by leaving out issues where international consensus is unlikely to emerge. Whereas previous attempts at international harmonisation in the field of proprietary security over ships failed largely because it proved impossible to overcome the conflict between the competing interests of the relevant shipping nations that preferred

165 Article 8(1).

166 To the extent that such agreements on the available remedies are permitted under the applicable law, see Article 12 and *Roy Goode*, Convention on International Interests in Mobile Equipment and Protocol thereto on Matters specific to Aircraft Equipment, Official Commentary, ed. 3, Unidroit Books 2013, para. 4.108.

167 Article 14.

168 See the international interests covered by Article 2.

169 See above *sub* E.

170 See above *sub* D.V.

171 See the references above fn. 119.

different groups of creditors (creditors financing the construction and purchase of ships, on the one hand, and the shipping service, supply and repair industries, on the other hand), the suggested extension of the Cape Town Convention system to ships would affect the position of secured creditors holding consensual proprietary only, *i.e.,* ship mortgages or hypothecations. Thus, the consensual proprietary security rights over ships could be strengthened and the (re-)financing of the worldwide merchant fleets could be supported without creating a corresponding disadvantage for the shipping service, supply and repair industries and the position of their maritime liens.

A similar policy of self-restriction has been followed under the recent Draft Convention for the Recognition of Judicial Sales of Ships prepared by the Comité Maritime International.[172] The judicial sale of ships, specifically as a type of enforcement of rights under proprietary security rights in ships, was also addressed by the 1967 Brussels Convention and 1993 Geneva Convention.[173] However, it was argued that an additional instrument dealing with these issues would be opportune,[174] even at the risk of overlap with the existing Conventions on Maritime Liens and Mortgages, the limited success of the 1993 Geneva Convention and the scant likelihood of many further accessions arguing in favour of a new international instrument that would avoid the internationally disputed issue of maritime liens which, as experience shows, has proved something of an obstacle to broad support, however welcome such broader solutions would be from the standpoint of international legal harmonisation and the efficiency of cross-border transactions.

G. Some specific issues to be considered in the drafting process

In the drafting of a new Protocol to the Cape Town Convention covering ships, the peculiarities of the shipping finance business would have to be taken into consideration and any amendment to the general principles of the Cape Town Convention that is deemed necessary could be agreed. It would certainly go too far to set out all the possible issues that could be taken into consideration in the drafting process, but some more relevant issues can be highlighted here.

1. Avoiding conflicts with other international instruments dealing with enforcement issues (arrest and judicial sales)

A new Protocol to the Cape Town Convention should avoid conflicts with the Brussels Convention relating to the Arrest of Seagoing Ships of 1952 and the Geneva Convention on the Arrest of Ships of 1999. The same should apply in relation to the proposed Draft Convention for the Recognition of Judicial Sales of Ships. Generally, the Cape Town Convention provides that the exercise of any remedies under the Convention should follow the procedural rules of the law of the forum.[175] This general rule ensures that the provisions of the law of the forum take precedence over those of the Convention, including any rules provided by international instruments to which the forum State is a party. However, it would appear that it could be considered to align the rules under the Cape Town Convention on the

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172 See the project webpage of the Comité: www.comitemaritime.org/Recognition-of-Foreign-Judicial-Sales-of-Ships/0,2750,15032,00.html

173 Article 11 of the 1967 Brussels Convention and Articles 11 s. of the 1993 Geneva Convention.

174 See the paper by *William Sharpe*, Towards an International Instrument for Recognition of Judicial Sales of Ships – Policy Aspects, which can be downloaded from the webpages of the Comité, see above fn. 172.

175 See Article 14.

immobilisation of the object as a form of relief pending final determination[176] with the rules of the 1952 and 1999 Arrest Conventions.

2. Non-consensual security rights

As discussed above, a Protocol on ships would differ from the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention in that it would not cover non-consensual security rights, *i.e.,* maritime liens.

However, caution would have to be applied even with regard to the application of those provisions in the Cape Town Convention that to a limited extent allow non-consensual proprietary security to be brought within the scope of the Convention. First, Article 39(1)(a) allows each Contracting State to deposit with the Depositary a list of categories of non-consensual rights or interests that have priority over an interest equivalent to a registered international interest under the national law of the Contracting State and which are to have priority over registered international interests under the Convention.[177] In effect, this comes close to a rule under which the determination of the priority status of the non-consensual security is to be determined under the rules of the same law that governs its creation, *i.e.*, the law of the Contracting State that has deposited the list which includes this security right or interest. While there are several legal systems that refer the issues of creation and priority of non-consensual security over ships to the same applicable law, other jurisdictions apply different conflict-of-laws rules to these matters.[178] Second, according to Article 40 each Contracting State may deposit with the Depositary a list of non-consensual security interests which will be registrable under the Convention as if they were registrable international interests and which will be regulated accordingly. This includes the determination of the priority status according to the order of registration.[179] While Article 40 does not go as far as Article 39 in conferring preferred priority status on the interests covered by this provision, it is to be noted that its effect is that an interest thus covered can no longer be treated as enjoying generally lower priority ranking than consensual proprietary security interests in the same asset, even if this would be the position if the conflict-of-laws provisions of the forum and the applicable legal regime for the determination of the priority status of this type of non-consensual security were applied. To solve this problem and in order to avoid venturing into the disputed areas of non-consensual security over ships, Articles 39 and 40 could be made subject to a rule in the additional Protocol on ships according to which the non-consensual interests covered in the declaration of the Contracting State concerned are to enjoy such a privileged priority position only if, according to the conflict-of-laws rules of the forum, the issue of the priority status of non-consensual security interests is to be governed by the laws of the Contracting State concerned or under any other legal regime under which an equivalent priority position is awarded to these non-consensual security interests.

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176 See Article 13(c).

177 In more detail, this provision operates as follows: it does not harmonise the conditions for the creation of the non-consensual rights or interests covered in the list deposited by the Contracting State; and such rights or interests will only arise if the conflict-of-law rules of the forum determine the law of the Contracting State concerned as the regime governing the issue of the creation of non-consensual security rights. Also, the Convention does not attempt to harmonise these conflict-of-laws rules. However, the priority status of this non-consensual security is determined on the basis of the provisions of the Convention but following the position of the Contracting State concerned as expressed in the declaration deposited with the Depositary.

178 See above *sub* D.V.3.

179 See Article 29.

3. Registrability of interests other than ship mortgages and hypothecations

While the 1926 and 1967 Brussels Convention and the 1993 Geneva Convention only cover ship mortgages and hypothecations, the Cape Town Convention system firmly acknowledges the use of retention of title and leasing as alternative agreements on which to base proprietary security.[180] This broad view of the various arrangements made by the parties that are to be covered by the secured transations regime of the Cape Town Convention corresponds to the functional approach to the law of proprietary security in general which has become the dominant view worldwide.[181]

However, it is an issue that should be carefully considered especially in relation to retention of ownership agreements whether the application of this modern functional approach would be consistent with the current expectations in the market practice as regards the use of retention of ownership agreements over vessels. It is therefore much to be welcomed that the current fact-finding work of the Comité Maritime International´s Working Group on Ship Financing Security Practices devotes much attention to the use of retention of ownership agreements over ships.[182] It is submitted that if the new Protocol would cover such agreements, this would be of a greatly beneficial effect for the use of retention of ownership agreements over ships in cross-border transactions: Retention of ownership agreements are typically not registrable in traditional registers of title and as unregistered interests, they are not likely to be recognised in a foreign forum.

4. Protection of the charterer

In some legal systems, there are complex rules concerning the restriction of the exercise of the rights under a ship mortgage, especially concerning the mortgagee´s right to take possession, where this would affect a charterer of the vessel.[183] Whether and under which conditions such a rule should be included in a Protocol covering security over ships is an issue that certainly deserves to be addressed in the drafting process of such a new Protocol. It should, however, be noted here that if the charterparty itself would be registrable under the new Protocol, the general priority rules of the Convention would be applicable to such a situation.

5. Registrability of interests in other assets in the marine sector

Finally, the preparation of a new Protocol on ships would constitute an opportunity to consider extending the scope of the Cape Town Convention system to other assets in the marine sector as well. Container fleets[184] and flettner rotors[185] are assets whose use as

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180 See Article 2(2). On this distinction and on the relevance of leasing and retention of ownership agreements concerning ships see also *Goode*, Security interests (*op. cit.* fn. 6), at 164.

181 UNCITRAL Legislative Guide on Secured Transactions (2007), Chapter IX, paras. 67 ss. (pp. 335 s.).

182 See the questionnaire referred to above in fn. 16.

183 For English law see *The "Myrto"* [1977] 2 Lloyds Rep 243; *Bowtle and Osborne*, (*op. cit.* fn. 157), at 179.

184 Containers had originally been suggested for inclusion under the scope of the Cape Town Convention, see Article 2(1)(e) of the first set of draft articles of a future UNIDROIT Convention on Interests in Mobile Equipment, March 1996, UNIDROIT document Study LXXII – Doc. 24. See also the report prepared for the 2013 UNIDROIT Governing Council, UNIDROIT 2013 - C.D. (92) 5 (c)/(d), at para. 76.

185 See the law blog operated by the law firm Van Steenderen: http://www.mainportlawyers.com/content/new-protocols-cape-town-convention-update-unidroit-governing-council%E2%80%99s-meeting-2014.

collateral has been suggested to be considered in this regard. Concerning the suitability of such additional maritime assets for an inclusion into the scope of the new Protocol, a similar analysis should be employed as underlying the determination of the scope of the draft Protocol on Matters specific to Agricultural, Construction and Mining Equipment, *i.e.,* the core question should be whether these are mobile assets of high value[186] that could be separately financed in the market practice.[187]

H. Conclusions

The law of proprietary security over ships is characterised by strong divergencies between the various legal systems and by a high degree of uncertainty for market participants, especially secured creditors, concerning the applicable law in the event of a dispute. This puts secured creditors at the risk of losing their security position, especially through the non-recognition of their registered security over a vessel before the courts of a foreign forum State, by an inadvertent failure to comply with registration procedures under a foreign law of registration or the unanticipated application of rules on the order of priority under the law of the forum. Such risks, together with the additional efforts and costs for legal advice that become necessary for secured creditors when conducting secured transactions in such an environment will reduce the availability of financing and increase its costs, including the premiums for credit insurance. All this ultimately goes to the detriment of the debtor seeking financing and in the current economic climate in the market for shipping finance no measure should be left unused that could improve the availability of credit and its conditions. The recent Brazilian Court of Appeals decision in the OSX-3 case is further proof that the current legal framework does not sufficiently protect the interests of secured creditors in cross-border disputes and action should be taken to remedy this situation.

The preparation of a new Protocol to the Cape Town Convention covering ships could be an enormously valuable contribution to the law of proprietary security over ships world-wide, most prominently:

(i) by providing for a registered international interest under the provisions of the Cape Town Convention and the new Protocol thereto that is accepted throughout the Contracting States, thereby eliminating the risk that a court in a Contracting State could deny the validity and effectiveness of a consensual proprietary security right such as a ship mortgage or a hypotecation over a vessel sailing under a flag other than that of the forum State on the basis of the argument that the security is registered not in the register of the forum State, but under the law of the flag;

(ii) by harmonising the requirements and details of registration of consensual security rights over ships, thereby doing away with the widely divergent procedures for the perfection of ship mortgages and hypothecations currently required under the various national laws;

(iii) by enhancing the publicity given to the registration of consensual security over ships through the introduction of a unified, efficient system of registration operated electronically, the workability of which has already been proven in practice for security rights in aircraft;

(iv) by harmonising the rules on the priority status as between consensual security rights over ships, thereby enhancing certainty in commercial transactions since parties

186 See Article 51(1) of the Cape Town Convention.

187 See the report of the third Study Group meeting UNIDROIT 2015 – Study 72K – SG3 – Doc. 5, para. 42.

would no longer need to consider the risks attendant upon the fact that each national legal system has its own rules concerning the priority status of such rights; and

(v) by providing for a harmonised set of remedies on default instead of the current distinction between the remedies available under common law mortgages and civil law hypothecations, thereby generally strengthening the position of the secured creditor by putting an emphasis on the availability of self-help remedies and on the possibility of appropriating of the collateral as a method for enforcement of the security.

It has been argued that there is generally no need for an international instrument where an equivalent result could be achieved through a reform of national laws.[188] While it is true that some of the issues mentioned above could be dealt with at national level as well, especially the harmonisation of remedies, the creation of an international interest and the unification of the registration system for all Contracting Parties under the new Protocol would be an advantage that can only be achieved through a new international instrument.

Moreover, while it generally would be more preferable to seek to attract additional Contracting Parties for existing conventions than to prepare a new international instrument,[189] also this reasoning should not argue against the preparation of a new Protocol on ships. The 1993 Geneva Convention is not likely to attract a significant number of additional Contracting Parties, especially among the important shipping nations, in addition to its present 18 Parties. A new Protocol on ships would have much better chances of obtaining broader support due to the fact that it would avoid the highly contentious issue of maritime liens.

Shipping finance is a market that has very peculiar characteristics, mainly the volatility of earnings in the shipping industry, its highly cyclical nature and the resulting risk of over-capacity, all of which affect freight rates, the demand for new shipbuilding and, indirectly, also the value of the ships liable to be used as collateral.[190] Nevertheless, while these factors often limit the application of a conventional credit analysis to ship financing, the cutting of transaction costs through the reduction of inefficiencies in the law remains an advantage in any financing environment. Strengthening the position of consensual proprietary security rights over ships, as would be the objective of a new Protocol on ships, would therefore be of huge significance for the financing and re-financing of the merchant shipping industry in the same way as it would be relevant for other industries.[191] To the extent that the legal environment of the present market for shipping finance has specific characteristics that should be taken into consideration in an international instrument on consensual security rights over ships, these specific issues could be addressed in the potential Protocol on ships and the relevant shipping organisations would be able to contribute to the drafting process, which of course would to a great extent rely upon their specialist expertise.

In conclusion, there is a clear case for the preparation of a new Protocol to the Cape Town Convention covering security over ships. Should UNIDROIT and the Comité Maritime International continue their work on this project and should they succeed in advertising its advantages to interested industry circles, it is to be expected that the project could well attract the necessary support by governments, industry and interested circles to become another successful addition to the Cape Town Convention system.

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188 Cf. *Gabriel* (*op. cit.* fn. 23), at 75.

189 See *Patrick Griggs*, Uniformity of Maritime Law – An International Perspective, in: Tulane Law Review 73 (1999), 1551, at 1569.

190 See *Alan* Brauner *and Peter Illingworth*, The bankers' perspective, in: Stephenson Harwood (eds.), Shipping Finance, ed. 3, Euromoney Institutional Investor 2006, 67, at 71 s.

191 See *Alcántara* (*op. cit.* fn. 6), at 232; *Goode*, Security interests (*op. cit.* fn. 6), at 165; *Haight* (*op. cit.* fn. 6), at 195; *Sotiropoulos* (*op. cit.* fn. 6), at 308