

**‘Either you’re the owner because you have a true lease or you’re a secured party, so you’re not going to get run over’**

– Vedder Price partner  
Francis Nolan III



Chris Frenandes

# Financial lessors win ‘back door’ protection

Marshall Islands law could spur sale leasebacks, reports **Greg Miller**

A nagging risk has long haunted financial investors who buy vessel assets and lease them back

to sellers in dire need of cash.

If bankruptcy ensues, a judge may conclude that the arrangement is not a true lease but, rather, a security agreement, and lessors may be deemed unsecured creditors.

Financial lessors in the aircraft

and rail sectors have been protected against this risk, but not in the maritime space – until now.

A creative solution was spearheaded by Vedder Price partner Francis Nolan III and the Maritime Law Association of the US (MLA) Marine Finance

Committee, which Nolan chairs. The first approach was made half a decade ago to US Congress. “We couldn’t get them interested,” Nolan conceded to *Fairplay*. “It was not a hot subject from the standpoint of their constituents.”

With the front-door strategy going nowhere, proponents opted for the ‘back door’.

As Nolan explained at a recent *Marine Money* conference: “Under US law, if a structure is recognised as a preferred mortgage or equivalent instrument in another jurisdiction and meets certain requirements, it would be enforceable as a preferred mortgage in the United States, so there’s a certain transferability of the effect.”

US Chapter 11 bankruptcy protection provides an automatic stay that applies worldwide. Thus, if a non-US law that treated financing charters as preferred mortgages was recognised by a US bankruptcy judge in a Chapter 11 case, it would theoretically

boast international reach.

With this in mind, Nolan and the MLA approached the world's second- and third-largest open registries – Liberia and the Marshall Islands.

Years of effort have now paid off. On 6 March the Marshall Islands parliament passed “first of its kind” legislation that permits a financing charter to be treated as a preferred mortgage for the owner of a Marshall Islands vessel. The law's text was primarily authored by Nolan. A spokesman for the Marshall Islands registry confirmed that the law should be certified and come into effect within the next two weeks.

Liberia is expected to follow suit. Panama, the largest open registry, was not initially approached “but we're glad to help them with it if they're interested,” Nolan told *Fairplay*, adding that “another run” at US Congress may be pursued.

Under the new Marshall Islands law, a lessor involved in a bankruptcy case can say: “I'm

the owner. If the court says ‘no’, they can say: ‘I'm the mortgagee, so I come ahead of these other creditors.’ Either you're the owner because you have a true lease or you're a secured party, so you're not going to get run over,” explained Nolan.

By reducing collateral risk, sale-leaseback interest could accelerate, which should be welcome news for cash-strapped owners. “A number of finance sources are willing to do a lease structure for 100% financing, whereas they're not willing to do it for an advance rate on a loan,” said Nolan.

The concept of leveraging open-registry jurisdiction law for global effect could also be mirrored through other innovations in the future. “The MLA Marine Finance Committee is looking at a number of these. We're not trying to be promiscuous with them, but to do it on a steady basis,” said Nolan. **F**

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