

Ship Finance 2021

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Lexology Getting The Deal Through is delighted to publish the eighth edition of *Ship Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China and Russia.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Lawrence Rutkowski of Seward & Kissel LLP, for his continued assistance with this volume.



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Contents

Introduction	3	Nigeria	55
Lawrence Rutkowski Seward & Kissel LLP		Funke Agbor and Chisa Uba Dentons ACAS-Law	
Brazil	5	Panama	62
Carlos Rameh, Renata Iezzi, Victor de Oliveira Fernandes, Paulo Mattar Filho and Marina Raschke Rameh Basch & Rameh Advogados Associados		Jorge Loaiza III Arias, Fábrega & Fábrega	
China	13	Russia	68
Yu-Lai Jin KaiRong Law Firm		Alexander Mednikov Jurinflot International Law Office	
Cyprus	21	Singapore	75
Marion Coukidou-Madella Chrysses Demetriades & Co LLC		V Hariharan Haridass Ho & Partners	
Japan	28	Sweden	80
Norio Nakamura and Kenji Sayama Yoshida & Partners		Gudmund Bernitz HFW	
Malta	35	United Arab Emirates	87
Kevin F Dingli, Suzanne Shaw and Louisa Dingli Dingli & Dingli Law Firm		Tien Tai and Andrzej Czernis HFW	
Marshall Islands	47	United Kingdom	94
John F Imhof Jr Vedder Price PC		Tony Rice and Ian Hughes HFW	
		United States	105
		Lawrence Rutkowski Seward & Kissel LLP	

Marshall Islands

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DUE DILIGENCE

Demonstrating title or legal ownership

- 1 | How does one demonstrate title to or legal ownership of a vessel registered under the laws of your jurisdiction?

Marshall Islands law establishes requirements for the vessel owner to demonstrate and affirm the facts of direct ownership of a vessel coming into the Marshall Islands flag. Although these requirements do not address ultimate or intermediate tiers of ownership, such as identification of parent entities in ownership structures, amendments to the Marshall Islands Associations Law that became effective in November 2017 require all Marshall Islands corporations, partnerships, limited partnerships and limited liability companies that are not publicly traded to maintain records of their ultimate beneficial ownership, and if they are non-resident domestic entities, to produce these records if requested by certain Marshall Islands authorities (see, for example, the Business Corporations Act (BCA), section 80, as to corporations, and the Limited Liability Company Act, section 22, as to limited liability companies). The same amendments require domestic Marshall Islands corporations that have issued bearer shares to record the ultimate beneficial ownership of such bearer shares with the registered agent for non-resident domestic entities for such bearer shares to maintain their validity (BCA, section 80(3)(c)).

To register a vessel in the Marshall Islands, it is necessary for the owner to 'furnish proof satisfactory to' the Commissioner or any Deputy Commissioner of Maritime Affairs demonstrating, among other things, the ownership of the vessel (the Maritime Act, section 208). The Maritime Act, section 209(1), requires that a written oath by sworn affidavit be submitted by an owner or owner's authorised representative for registration 'declaring [. . .] the name and residence of any other owner and his citizenship, each owner's proportion, and the name of the affiant and his citizenship'.

Whenever a vessel operating under the Marshall Islands flag is sold, the Maritime Act, section 225(1), requires that the sale or transfer is evidenced 'by a written instrument in the nature of a bill of sale to which is attached a true copy of the vessel's latest Certificate of Registry'. For registration of a newbuilding, the registrant must provide a builder's certificate from the shipbuilder, certifying, among other things, that the builder constructed or directed the construction of the vessel, the person for whom it was built and the date of delivery (the Maritime Act, section 226).

Liens

- 2 | How can one determine whether there are any liens recorded over a vessel?

The only maritime liens that can be recorded against a vessel in the Marshall Islands registry are preferred mortgage liens. Marshall Islands law does not provide a vehicle for registration of other maritime liens.

- 3 | How does one determine whether there are any security agreements, liens, charges or other encumbrances granted by a vessel owner or affiliated party who might be a borrower, guarantor or other credit party in connection with a vessel finance transaction?

One can determine whether there are any preferred mortgage liens registered against a specific vessel by searching the record, or more practically, by requesting a certificate of ownership and encumbrance from the Deputy Commissioner's office. A lien or charge against a vessel arising from something other than a preferred mortgage need not be filed under Marshall Islands law. In fact, there is no filing office for such liens to be registered or recorded. Security agreements, liens, charges or other encumbrances may be granted by an owner or disponent owner over charter hire, freights and other earnings of a vessel or other collateral, such as stock, and other ownership interests as credit support in a ship finance transaction. These are usually recorded in the domicile of the assignor or pledgor, either as charges registered in the company's register or as financing statements filed under the Uniform Commercial Code, for example, in the United States.

Public registry searches

- 4 | Can one determine whether an obligor registered in your jurisdiction is duly organised and in good standing from a search of a public registry?

Generally, this is possible. In practice, however, this is normally addressed by requesting a certificate of good standing from the Trust Company of the Marshall Islands, Inc through International Registries Inc.

- 5 | Can the shareholders or other equity interest holders, directors and officers or other authorised signatories of an obligor organised in your jurisdiction be determined from a search of a public registry? If not, how are these parties customarily identified?

Marshall Islands law does not, strictly speaking, require the disclosure on the public record of shareholders, members or other equity interest holders, directors, officers or other authorised signatories. This issue is usually addressed in transactions by requiring incumbency certificates stating the identities and interests in the specific entity. Often there are additional disclosure requirements and supporting documentation required, such as resolutions appointing officers, elections to the board and inspection of the stock transfer ledger, where relevant. Marshall Islands law still permits the issuance of bearer as well as registered shares in Marshall Islands corporations.

Debt obligation

- 6 | What corporate or other entity action is necessary for an obligor to enter into or guarantee a debt obligation? When is action by the board of directors or other governing body required? Must shareholders approve a guarantee?

Each Marshall Islands corporation is empowered to guarantee the obligations of others unless specifically limited in the Business Corporations Act (BCA) or in the articles of incorporation of the corporation (BCA, section 15(g)) provided it is in furtherance of its corporate purposes. If that is not the case, or to avoid the 'corporate purposes' issue entirely, BCA section 16 allows a corporation to issue a guarantee, regardless of whether it is in furtherance of its corporate purposes, by obtaining the affirmative vote of the holders of a majority of the outstanding shares in the corporation at a shareholders' meeting, the written consent of all shareholders, or if the corporation's articles of incorporation so provide, the written consent of the holders of a majority of the outstanding shares (see also BCA, sections 16 and 67). The same procedure can be used to authorise the corporation to secure the guarantee with a grant of a security interest in corporate property (BCA, sections 16 and 67).

Obligations of foreign lenders

- 7 | Must foreign lenders qualify to do business in your jurisdiction to extend credit to a borrower organised in your jurisdiction? Will foreign creditors be deemed resident as a consequence of making a loan or other extension of credit to an obligor within your jurisdiction?

There is no requirement for a foreign lender to qualify to do business in the Marshall Islands to extend credit to Marshall Islands persons in respect of vessels registered under the Maritime Act. Lenders seeking to make loans internally in the territory of the Marshall Islands must comply with local laws affecting banks and other business operations.

REPAYMENT

Central bank and regulatory approval

- 8 | Is central bank or other regulatory approval required for repayment of a loan in foreign currency?

There is no such requirement in Marshall Islands law with respect to non-resident domestic borrowers repaying loans outside the Marshall Islands. In fact, section 310 of the Maritime Act permits obligations secured by a preferred mortgage to be denominated in any unit or units of account or currency as the parties may agree.

Usury laws

- 9 | Do usury laws limit the interest payable to a lender in respect of a vessel financing?

Section 312 of the Maritime Act specifically provides that 'a Preferred Mortgage may secure such interest, including interest on interest, on an obligation secured by the mortgage as the parties may agree'. This provision is based on a similar provision in section 31322(b) of the US Commercial Instruments and Maritime Liens Act. Bearing in mind that few Marshall Islands-flagged vessels in foreign trade are arrested and foreclosed upon in the Marshall Islands itself, it will generally fall to the jurisdiction where a vessel is arrested to foreclose a preferred mortgage to determine whether this section 312 would be enforceable or against public policy in the place of arrest. We know of no reported cases where a court has upheld a usury defence in the face of provisions such as section 312 of the Maritime Act.

Withholding taxes

- 10 | Are withholding taxes payable on principal or interest payments to non-resident lenders?

There are no withholding taxes imposed by the Marshall Islands on the repayment of principal or interest to non-resident lenders. This is not surprising, as most, if not all, non-resident domestic corporate income is exempted from income tax (the Business Corporation Act, section 12).

REGISTRATION OF VESSELS

Eligibility for registration

- 11 | What vessels are eligible for registration under the flag of your country? Are offshore drilling rigs or mobile offshore drilling units considered vessels under the laws of your jurisdiction? What is the effect of registration?

Pursuant to chapter 9 of the Maritime Act, derived from the original Domestic Watercraft Act, the Marshall Islands has one registry for vessels operated exclusively within Marshall Islands waters. Vessel documentation for internationally trading vessels is done through the Maritime Act, Chapter 2, Part I. This registry is considered an open registry, sometimes referred to as a flag of convenience.

Section 203 of the Maritime Act sets out minimum threshold requirements for registration under the Act. Any seagoing vessel engaged in foreign trade is eligible, as are declared commercial fishing vessels of at least 24 metres in length, commercial yachts of at least 24 metres and private yachts of at least 12 metres. Additionally, there is a maximum vessel age limit of 20 years (section 203), which can be waived under certain conditions. Section 203 also permits the registration of vessels under construction, provided the registrant has title to the vessel under construction and there is no restriction against such registration in the jurisdiction where the vessel is being built.

The Maritime Act does not define the term 'vessel'. Section 113 of the Maritime Act does contain a provision that adopts the non-statutory general maritime law of the United States as the general maritime law of the Marshall Islands, to the extent that it does not conflict with the Maritime Act or any other provision of Marshall Islands law. The term 'vessel' in United States maritime law, once a part of the general maritime law of the United States, was codified into statute in the mid-19th century, so that United States definitions of 'vessel' may be useful or even persuasive, but are not a definite part of Marshall Islands law. There are, in fact, offshore drill-ships and mobile offshore drilling units registered as vessels under the Maritime Act.

- 12 | Who may register a vessel in your jurisdiction?

Under section 203 of the Maritime Act, a vessel may be documented if owned by a citizen or national of the Marshall Islands or by a foreign maritime entity qualified in the Marshall Islands. Entities formed under the Associations Law (including the Business Corporations Act (BCA)) are considered nationals. A qualification as a registered foreign maritime entity is achieved under Division 13 of the BCA. Essentially, these provisions allow foreign entities, otherwise empowered under their home jurisdictions to own vessels, to apply for the registration of, register and then document Marshall Islands-flagged vessels. Section 119(2) of the BCA and its implementing Maritime Regulations require applicants to provide information on, among other things, the nature and powers of the entity, its legal representatives, its address and principal place of business, management and similar data. As a practical matter, the threshold for qualification is not significant and numerous Marshall Islands vessels are documented in the names of qualified foreign maritime entities.

Registry for international shipping operations

13 | Is there an alternate registry for international shipping operations?

The dominant registry in the Marshall Islands is the open international registry. Chapter 2 of the Maritime Act governs the registration and mortgaging of vessels in foreign trade. This registry dwarfs the purely domestic vessel registry in the Marshall Islands, which is regulated by the Marshall Islands Domestic Watercraft Act. The international registry requires that the owner of a Marshall Islands vessel be a Marshall Islands citizen, national or qualified foreign maritime entity (the Maritime Act, section 203), but imposes no citizenship requirements on the ownership of such an entity.

SHIP MORTGAGES AND OTHER LIENS OVER VESSELS

Types of ship mortgage

14 | What types of ship mortgages exist and what obligations may a ship mortgage secure? Can contingent obligations, including swap obligations, be secured? Are there standardised forms?

The Marshall Islands follows the American model of ship mortgages, unifying the essential features of a mortgage grant with covenants, representations, warranties, events of default and other provisions. While there are requirements to establish a preferred mortgage, there is no required form as such. A Marshall Islands preferred mortgage is flexible enough to secure any obligation of the mortgagor debtor. A preferred mortgage may secure a term loan, future advances and contingent obligations, including guaranties, swap obligations and other obligations, under present commitments or agreements (the Maritime Act, section 309).

Under the financing charter provisions enacted in the Marshall Islands in March 2013, the Marshall Islands became the first registry to permit the registered owner in a financing charter to record the bareboat charter as a type of preferred mortgage. These provisions, as further amended, allow the registered owner, typically a financial institution or affiliate, to hold title and be deemed a preferred mortgagee up to 'the maximum aggregate of the nominal amount of all charter hire payments, termination payments, and purchase or put option amounts which could under any circumstances be due and payable under such financing charter, exclusive of any interest, indemnities, expenses, or fees' (the Maritime Act, section 302A).

Section 302A of the Maritime Act permits financing structures similar to those used for aircraft and railcar net lease financing. To date, numerous charters have been registered as preferred mortgages in the Marshall Islands under this law, with the vast majority of these involving charterers in Asia and the rest involving charterers in Europe and North America.

Required form

15 | Give details of any required form for ship mortgages in your jurisdiction.

There is no required form of Marshall Islands preferred mortgage, as such. Marshall Islands mortgages follow the American model, similar in some respects to what a red-ensign system might include in a deed of covenants. There are, however, elements that must be included in a Marshall Islands mortgage in order for it to be deemed a 'preferred mortgage.' These elements are more particularly described in Chapter 3 of the Maritime Act.

Registration of mortgages

16 | Who maintains the register of mortgages? What information does it contain and where are such filings to be made? What is the effect of registration?

All instruments of 'sale, conveyance, hypothecation, mortgage or assignment of mortgage of any vessel' as well as financing charters are recorded and maintained in the central office of the Marshall Islands Maritime Administrator in the United States (the Maritime Act, sections 302 and 302A). As a practical matter, the functions of the Maritime Administrator are delegated to and performed by the Commissioner of Maritime Affairs and various deputy commissioners in New York, London and elsewhere around the world. However, the central repository of all document filings related to vessels is in the United States.

17 | Must the total amount of the mortgage be stated therein? Must the mortgage contain a maturity date? Must the underlying debt instrument be filed with or attached to the recorded mortgage?

Section 302(3)(e) of the Maritime Act requires that a mortgage state 'the amount or amounts of the direct or contingent obligations [...] that are or may become secured by the mortgage.' In the case of revolver facilities or committed facilities not fully drawn at closing, the mortgage may either be stated as the maximum amount that may be drawn at any time or as the 'aggregate of all possible advances' (the Maritime Act, section 309). Only indebtedness incurred prior to the maturity date or date of termination of a preferred mortgage made 'pursuant to agreement' shall retain its status and ranking as a preferred maritime lien, and a preferred mortgage made 'by agreement' must set forth, in addition to other terms and conditions, the maturity date or a statement of the date of termination if it is other than the maturity date (the Maritime Act, section 309). There is no stated requirement to attach and file a copy of the agreement creating the obligation secured. However, as a matter of practice, parties do normally attach the form of or a copy of the executed note, credit facility, guaranty or other evidence of the secured obligation.

18 | Can a mortgage be registered in the name of an agent or trustee for the benefit of multiple lenders?

Mortgages are generally registered in favour of a security trustee acting on behalf of lenders in all transactions in which more than one lender is or may become party to the credit agreement that the mortgage is intended to secure.

Filings on transfer

19 | If the mortgagee is an agent or trustee for a lending syndicate, must any filings be made upon transfer of a portion of the underlying debt among existing lenders or to a new lender?

By use of the security trustee, transfers of the underlying debt positions need not be registered in the Marshall Islands registry.

20 | If the mortgagee transfers its interest to a new lender, agent or trustee what filings are required? Is the mortgagor's consent required?

The transfer of the mortgagee's position by assignment is not required to maintain the validity of the mortgage, but it should be done for protection of the assignee mortgagee's rights with regard to the assignor and also to avoid difficulties and delays in establishing the assignee's right to foreclose on the mortgage at some time in the

future. Marshall Islands law does not require the consent of the mortgagor for assignment although the mortgagor and mortgagee may agree otherwise.

Maritime liens

21 | What other maritime liens over vessels are recognised in your jurisdiction? Do these claims give rise to a right to arrest a vessel? In what circumstances may associated ships be arrested?

The Maritime Act states the priority that the Marshall Islands High Court, sitting in admiralty, would apply in a ship mortgage foreclosure. Section 318 of the Maritime Act states that a preferred mortgage would have priority over all claims except preferred maritime liens for:

- damages caused by the vessel and arising from a tort;
- 'unpaid tonnage taxes, fees, penalties and other charges arising under' the Maritime Act or its implementing regulations (the Maritime Act, section 238);
- crew wages;
- general average;
- salvage (including contract salvage); and
- 'expenses and fees allowed and costs taxed by the court.'

In addition, and depending on the jurisdiction in which lien enforcement is sought, certain maritime lien claims for necessities against a vessel that arose prior to the registration of a preferred mortgage against the vessel could also have priority over the lien of the preferred mortgage. Section 319(1) of the Maritime Act states that:

Whoever furnishes repairs, supplies, towage, use of drydock or marine railway, or other necessities, to any foreign or domestic vessel upon the order of the owner or person authorised by the owner, shall have a maritime lien on the vessel.

Depending on the jurisdiction in which lien enforcement is sought, the relative priority of these necessities liens will rank in a superior or subordinate position to the lien of any preferred mortgage registered against the vessel regardless of when the mortgage was recorded.

22 | What maritime liens rank higher than a mortgage lien?

Although rankings may vary from jurisdiction to jurisdiction, section 318 of the Maritime Act, which may or may not apply depending on where lien enforcement is sought, states that a preferred mortgage would have priority over all claims except preferred maritime liens for:

- damages caused by the vessel and arising from a tort;
- 'unpaid tonnage taxes, fees, penalties and other charges arising under' the Maritime Act or its implementing regulations (the Maritime Act, section 238);
- crew wages;
- general average;
- salvage (including contract salvage); and
- 'expenses and fees allowed and costs taxed by the court.'

In addition, and depending on the jurisdiction in which lien enforcement is sought, any maritime lien claim for necessities against a vessel could have priority over or be subordinate to the lien of a preferred mortgage on such vessel regardless of when the preferred mortgage was recorded.

As between mortgages, the rule is 'first in time, first in right,' subject to any consensual subordination or intercreditor arrangement between mortgagees.

Non-mortgage liens

23 | May non-mortgage liens be recorded over a vessel?

Only preferred mortgage maritime liens can be recorded against vessels in the Marshall Islands registry. There is no facility or procedure to accept for filing evidence of any other type of lien, maritime or otherwise, against a vessel. In practice, lawyers may file charges in the company's register or file Uniform Commercial Code financing statements against a foreign owner. Such filings are only in the nature of 'belt and braces' efforts, and are not expected to be relied upon.

'Foreign' flag vessels

24 | Will mortgages on 'foreign' flag vessels be recognised in your jurisdiction? If so, do they share the same priority as those on vessels registered under the laws of your jurisdiction?

The Maritime Act, section 317, provides that foreign mortgages, hypothecations or similar charges 'created as security upon any documented foreign vessel' are also recognised in the Marshall Islands courts as 'preferred mortgages' if they are 'duly and validly executed and registered' under the laws of the nation where the foreign vessel's ownership is documented. Marshall Islands law does not distinguish between preferred mortgages on Marshall Islands vessels and foreign preferred mortgages on foreign vessels either in terms of mortgage foreclosure procedures or in the ranking and priority of liens. Differences might arise, however, based on treatment in the jurisdiction where liens arose. This goes more to the question of whether a maritime lien is recognised in the place it is claimed to have arisen, such as a bunker lien, which is not universally recognised.

Enforcement of mortgages

25 | What is the procedure for enforcing a mortgage in your jurisdiction by way of foreclosure? Are interlocutory sales permitted? How long does a judicial sale take? What are the associated court costs and how are they calculated?

Other than vessels operating only domestically in the Marshall Islands, it would be highly unusual to arrest and foreclose a Marshall Islands- flagged vessel or any foreign vessel under the jurisdiction of the Marshall Islands High Court. In fact, it is doubtful that any significant numbers of Marshall Island flag vessels ever call at the Marshall Islands during their service life.

Sale by mortgagee

26 | May a vessel be sold privately by a mortgagee? Will the sale discharge liens over the vessel?

The Maritime Act is silent on whether a mortgagee may sell a vessel privately in the Marshall Islands and what effect that would have on claims against the vessel. Section 318 of the Maritime Act provides that a sale of a vessel in an *in rem* suit in the Marshall Islands High Court would terminate all pre-existing claims in the vessel. The proceeds would be applied in payment of claims of creditors.

The Maritime Act, section 316(2), does provide that a preferred mortgage on a Marshall Islands vessel may be enforced '*in rem* in Admiralty or otherwise in any foreign country in which the vessel shall be found' and defers to the enforcement procedures in the country of arrest.

Generally speaking, a vessel will be 'free and clear' of all liens and claims whatsoever following an arrest and foreclosure sale in a public auction overseas. In the United States it is possible, but highly unusual outside of the bankruptcy context, for a mortgagee to arrange

the sale of a vessel privately after arrest subject to confirmation by a federal court. It is unclear at best whether such sales, even if valid in the United States, would be given wide recognition in other countries.

Default under mortgage

27 | Will the courts of your jurisdiction enforce mortgage provisions stipulating the appointment of a receiver on default under the mortgage?

Section 316 of the Maritime Act provides that the lien of a preferred mortgage may be enforced *in rem* against a vessel in the Marshall Islands courts and also provides for *in personam* action against a shipowner on default of a preferred mortgage on a Marshall Islands vessel. This section also specifically permits the initiation of *in rem* proceedings in foreign courts. In reality, any request for appointment of a receiver would be grounded in the law of the forum where the vessel is arrested or where there is jurisdiction over the person of the shipowner. So, for example, a Marshall Islands vessel might be arrested in the United States under 46 USC section 31325(b)(1) and a US District Court, acting under 46 USC section 31325(e), might 'appoint a receiver and authorize the receiver to operate the mortgaged vessel'.

Limitations on rights of self-help

28 | What are the limitations on rights of self-help by a mortgagee?

Most nations insist on the sale of arrested vessels by or through specialised courts, admiralty or otherwise, as a predicate to the discharge of all liens and encumbrances. Resort to self-help remedies as an aid in advance of foreclosure has long been in use in many countries in the enforcement of ship mortgages, including Marshall Islands preferred mortgages. Inasmuch as Marshall Islands law adopts the non-statutory general maritime law of the United States (Maritime Act, Section 113), the exercise of self-help remedies on a mortgage cannot breach the peace.

Duties to owner or third-party creditors

29 | What duties does a mortgagee owe to an owner or third-party creditors?

Marshall Islands law states notice requirements for the arrest and foreclosure of vessels by the High Court. These are set out in section 316(1) of the Maritime Act, in the following language:

In addition to any notice by publication, actual notice of the commencement of suit shall be given by the libellant, in such manner as the Court directs, to the Master, other ranking officer, or caretaker of the vessel, and to any person who has recorded a notice of claim of an undischarged lien upon the vessel, unless after search by the libellant satisfactory to the Court such person is not found within the [Marshall Islands]. Failure to give such notice shall not constitute a jurisdictional defect, but the libellant shall be liable to such person for damages in the amount of his interest in the vessel terminated by the suit.

The provision does not indicate where the libellant might search for any recorded notice of claims of lien, however, the Maritime Act, which provides for the registration of vessels and recordation of mortgages, does not provide for the recordation of claims of liens.

COLLATERAL

Finance leases

30 | May finance leases or other charters be recorded over vessels flagged under the laws of your jurisdiction?

Since early 2013, Marshall Islands law has permitted the recordation of financing charters and elevated their status to a species of preferred mortgage. Section 302A of the Maritime Act provides that a bareboat or demise charter can be registered for recordation by either the documented owner or the charterer. For the charter to be registered, the charter must be signed and acknowledged by both parties; include the name and official number of the vessel, the date of the charter and the names and addresses of both parties; and state the total 'nominal amount of all charter hire payments, termination payments, and purchase and put option amounts which could under any circumstances be due and payable under such financing charter, exclusive of any interest, indemnities, expenses, or fees.' Merely registering or recording a document as a financing charter does not make it so. A court asked to enforce a registered financing charter could determine based on the evidence that the agreement is not a financing charter or does not create a security interest in favour of the documented owner under applicable law.

Section 302A also allows a documented owner under a financing charter itself to mortgage the vessel under more conventional mortgages. In this manner, if a charter is found not to be a 'financing charter' and, therefore, not a mortgage lien on the vessel, at least the conventional mortgage would secure debt on the vessel.

31 | May finance leases be recharacterised by a court as a financing contract? If so, is there any procedure for protecting the lessor's interest against third-party creditors?

A court could determine that a charter registered as a 'financing lease' is not in fact a financing lease because of its economic characteristics and thereupon recharacterise the charter as a true lease, operating agreement or otherwise, leaving the documented owner to be characterised as the true owner and not a secured party. If the documented owner is found to be a true owner, its claim to the vessel would fall behind all creditors. In any case where this result would seem to be a significant risk, the parties should structure the deal at the outset to include back-leverage secured by conventional preferred mortgages, however, the concerns that drove the creation of section 302A of the Maritime Act came from the opposite direction, the fears of a titleholder that his or her charter would be recharacterised as an unperfected security interest.

Security interests

32 | How is a security interest created over earnings of a vessel, charter contracts, insurances, etc? How are these security interests perfected?

These security interests are generally perfected by filing or other action against the pledged asset where it is maintained or where the payment debtor of the obligation is found. With regard to charter hire, earnings and other revenue streams, a financial institution, lender or lessor would generally require payment of all receipts into a designated account controlled by the secured party either from the start or pursuant to some springing mechanism upon default. This usually, but not always, includes notice of the assignment given to the source of the payments and acknowledgement by the payment obligor, such as the charterer, for example. Lessors and lenders generally require payment through money centre banks, and it is highly unlikely that a filing in the Marshall Islands would be needed to perfect a security interest in the accounts.

33 | Must security interests against non-vessel collateral be registered to be enforceable? If so, where are such filings made?

This will depend on a number of factors, including the nature and location of the collateral or the obligor with respect to that collateral. In no case is the filing location likely to be in the Marshall Islands. International shipping operating under the Marshall Islands flag will use money centre banks to deposit escrowed funds and to collect charter hire and freights. These types of property will not touch the Marshall Islands. Pledges of shares or limited liability company interests in Marshall Islands shipowners can be perfected by delivery of certificated shares or interests into the possession or control of the secured party, coupled with undated director resignations and powers of attorney. In the United States, by way of example, there is provision for filing certain security interests in property owned by persons not present in the United States.

34 | How is a security interest over a deposit account established? How is a security interest perfected?

Perfection on deposit accounts is not done in the Marshall Islands unless the account is established in a Marshall Islands bank. In practice, the perfection of a security interest in a deposit account in jurisdictions like the United States is accomplished by a combination of pledge and some form of account control agreement in which the pledgor, the deposit bank and the secured party agree that funds will not be released from the account without the consent of the secured party, either at any time or following an event of default, and in certain circumstances, particularly default, the secured party is entitled to withdraw and apply the funds against the secured obligations. Where available in the account jurisdiction or the jurisdiction of the debtor, sometimes a filing statement or charge may be registered.

35 | How are security interests in non-vessel collateral enforced?

The method of enforcement will vary according to the collateral type, the jurisdiction where the collateral is found and the powers that the collateral owner has contractually granted to the secured party in the remedies provisions of the loan, pledge or guaranty documents. The remedies will normally include self-help remedies by statute or by contract as well as foreclosure through the courts, followed by public auction or another approved sale method.

Share pledges

36 | How are share pledges for vessel financings established? Are share pledges or share charges common in your jurisdiction?

Pledges of shares or other ownership interests are established by the grant normally included in a pledge agreement. The pledge is usually accompanied by delivery of the original certificates evidencing the pledged securities to the secured party together with undated resignation letters from the board or other management body. If the securities are not certificated, provisions prohibiting the subsequent issuance of certificates are usually included in the pledge agreement or in a separate uncertificated securities agreement. Pledges of shares or membership interests in Marshall Islands entities are very commonly required where loans are made to Marshall Islands shipowners.

37 | Is there a risk that a pledgee, before or after exercise of the share pledge, may be exposed to debts or other liabilities of the pledged company?

There is a risk of exposure where the pledgee assumes, in one way or another, the active management of the company whose shares have been pledged. The law that determines that liability will often be that applicable to the underlying tort or civil wrong that occurs, whether it is a vessel disaster, fraudulent conveyance, defaulted statutory obligation or other liability basis.

TAX CONSIDERATIONS FOR VESSEL OWNERS

Domestic taxation

38 | Is the income earned by the owners of vessels registered in your jurisdiction subject to domestic taxation? At what rate?

Income earned by non-resident entities (either domestic or foreign) from any source, including the operation of Marshall Islands-flagged vessels registered under the Maritime Act, is exempt from Marshall Islands taxation (the Business Corporations Act (BCA), section 12). The provision specifically identifies corporations, partnerships, trusts, unincorporated associations and limited liability companies within the meaning of 'entity.' The exemption applies to:

[A]ny corporate tax, net income tax on unincorporated businesses, corporate profit tax, income tax, withholding tax on revenues of the entity, asset tax, tax reporting requirement on revenues of the entity, stamp duty, exchange controls or other fees or taxes other than those imposed by sections 8 [fees on filing articles of incorporation and other documents] and 9 [annual registration fee] [of the BCA].

See also the Revised Partnership Act, section 73, and the Limited Partnership Act, section 73.

Tonnage tax

39 | Is there an optional tonnage tax exempting vessel owners from tax on income?

There is a tonnage tax on vessels registered in the Marshall Islands. However, this is not paid to gain an exemption from income tax, which generally does not apply to non-resident domestic or foreign companies.

Tax incentives

40 | What special tax incentives are available to shipowners registering vessels in your jurisdiction?

Income earned by non-resident entities (either domestic or foreign) from the operation of Marshall Islands-flagged vessels registered under the Maritime Act is exempt from Marshall Islands taxation (the Business Corporations Act, section 12; see also the Revised Partnership Act, section 73, and the Limited Partnership Act, section 73).

Other tax provisions

41 | Are there any other noteworthy tax provisions specifically applicable to shipping, shipping income or ship finance?

To assist the European Union and the Organisation for Economic Cooperation and Development in their efforts to limit the use of preferential tax regimes, the Marshall Islands Registrar responsible for non-resident domestic entities promulgated the Economic Substance

Regulations, 2018, which were last amended on 29 August 2019 (as amended, the ESR).

The ESR apply to all non-resident Marshall Islands corporations, partnerships, limited partnerships and limited liability companies unless their businesses are centrally managed and controlled from outside of the Marshall Islands and they are tax resident outside of the Marshall Islands, and to all Marshall Islands foreign maritime entities whose businesses are centrally managed and controlled in the Marshall Islands, unless they are tax resident outside of the Marshall Islands (relevant entities) (the ESR, sections 2(s) and 4). The ESR require that relevant entities engaged in certain relevant activities, including the ownership, operation or chartering of Marshall Islands-flagged vessels, satisfy an economic substance test in relation to those activities (the ESR, sections 2(u) and 4). Although special provisions apply to relevant entities engaged in certain businesses, including pure equity holding companies, a relevant entity will generally satisfy this test if:

- the relevant entity is directed and managed in the Marshall Islands in relation to each relevant activity in accordance with the ESR;
- having regard to the level of each relevant activity carried out in the Marshall Islands, the relevant entity has an adequate number of qualified employees in the Marshall Islands, has an adequate physical presence in the Marshall Islands, and has an adequate amount of expenditure incurred in the Marshall Islands; and
- the relevant entity carries out core income-generating activity in the Marshall Islands in relation to each relevant activity in accordance with the ESR (see the ESR, section 4(2)).

A relevant entity that violates this economic substance test can be liable for a fine of up to \$50,000, revocation of its formation documents and dissolution, or both, and a relevant entity that violates the economic substance test for two or more consecutive financial periods can be liable for a fine of up to \$100,000, revocation of its formation documents and dissolution, or both (the ESR, section 7).

Beginning on 1 July 2020, each non-resident domestic Marshall Islands corporation, partnership, limited partnership, limited liability company and each Marshall Islands foreign maritime entity, in each case incorporated, organised, formed, or in the case of the Marshall Islands foreign maritime entity, registered on or after 1 July 2020 is required to submit an annual economic substance declaration to the Registrar, with each declaration due not later than 12 months after each anniversary of such incorporation, organisation, formation or registration occurring after 1 July 2021. In the case of each Marshall Islands non-resident domestic corporation, partnership, limited partnership, limited liability company and each Marshall Islands foreign maritime entity, in each case incorporated, organised, formed, or in the case of the Marshall Islands foreign maritime entity, registered before 1 July 2020, each annual declaration must be submitted to the Registrar not later than 12 months after each anniversary of such incorporation, organisation, formation or registration occurring on or after 1 July 2020 (the ESR, section 6; section 12 of Guidance and Frequently Asked Questions on Economic Substance, published by the Registrar on 17 October 2019, as amended; and certain telephone discussions with a representative of the Marshall Islands Registry).

INSOLVENCY AND RESTRUCTURING

General scheme of reorganisation or insolvency administration

42 | Is there a general scheme of reorganisation or insolvency administration in your jurisdiction?

No, the Marshall Islands has no such procedure. We understand that it has an internal procedure in the nature of an assignment for the

benefit of creditors, but that it is not adequate to work through a shipping insolvency where worldwide jurisdiction over the debtor's assets is critical to success.

Foreign court rulings

43 | Will the courts of your jurisdiction respect the rulings of a foreign court presiding over reorganisation or liquidation proceedings?

There is not much jurisprudence to say definitively, but it is believed that the Marshall Islands would respect such orders assuming the proceedings were not conducted in a manner that violates public policy.

Model Law on Cross-Border Insolvency

44 | Has your jurisdiction adopted the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law?

According to the website of the UN Commission on International Trade Law (UNCITRAL), the Marshall Islands has not adopted the model law on Cross-Border Insolvency.

Order of priority

45 | What is the order of priority among creditors? In what circumstances will creditors be required to disgorge payments from an insolvent company?

The order of priority among creditors is not apparent since no significant proceedings have occurred or are expected to occur in the Marshall Islands because the statutory infrastructure for bankruptcy is not present.

Security provision by vessel owner

46 | May a vessel owner provide security on behalf of other related or unrelated companies? What are the requirements for it to be enforceable?

A Marshall Islands vessel owner may guarantee the obligations of another entity or provide a security interest in the vessel owner's property, including a mortgage over the owner's vessels, to secure the obligations of another in furtherance of the corporate purposes of the vessel owner (Business Corporations Act, section 15(g)) or, if not in furtherance of its corporate purposes, by obtaining the affirmative vote of the holders of a majority of the outstanding shares in the corporation at a shareholders' meeting, the written consent of all shareholders or if the corporation's articles of incorporation so provide, the written consent of the holders of a majority of the outstanding shares (see also BCA, sections 16 and 67). The same procedure can be used to authorise the corporation to secure the guarantee with a grant of a security interest in corporate property (BCA, sections 16 and 67). A lender or other guaranteed party should take care that any such guaranty or grant of security is grounded in the guarantor's corporate purposes and approved by shareholders. The guaranty or grant should recite with some particularity the relevant corporate purposes, if any, and related business interests and the reliance of the guaranteed party or secured party on the guaranty or security grant.

Parties relying on the security interest in collateral should also be aware that other pre-existing creditors of the security interest grantor could make arguments that the grant of a security interest could in certain circumstances constitute a fraudulent conveyance, especially when there is no demonstrable benefit to the granting entity and the assets of the grantor prove insufficient to satisfy other creditors of the grantor entity.

Law of fraudulent transfer

- 47 | Is there a law of fraudulent transfer that permits a third-party creditor to challenge, for example, the grant of a mortgage because of insolvency of the mortgagor or insufficient consideration received by the mortgagor in exchange for the grant of the mortgage?

The applicable law of fraudulent conveyance is not likely to be that of the Marshall Islands. Since a challenge based on a fraudulent conveyance will no doubt come from an adversely affected creditor, the applicable law might be that where the transfer took place or its effects occurred. A number of bankruptcy cases begun by Marshall Islands companies have been filed and conducted in the United States, and the United States law of fraudulent conveyances might apply. The commercial civil law of the Marshall Islands is, in any event, largely consistent with United States law generally. In the unlikely event that a creditor challenged a transfer as fraudulent, there is no reason to believe the analysis or result would be different than would occur in the United States courts.

Petitions by creditors

- 48 | How may a creditor petition the courts of your jurisdiction to declare a debtor bankrupt or compel liquidation of an insolvent obligor?

This chapter is confined to the activities of non-resident Marshall Islands shipping companies doing business with creditors around the world; it is highly unlikely that the troubled debtor or its pursuing creditors would resort to the courts of the Marshall Islands. The overwhelming evidence is that bankruptcy and insolvency proceedings in which survival or reorganisation is sought are brought in the US federal bankruptcy courts by the filing of either a voluntary petition by the debtor or an involuntary petition by a group of creditors.

Model Netting Act

- 49 | Has your jurisdiction adopted the Model Netting Act of the International Swaps and Derivatives Association (ISDA)? If not, may a swap provider exercise its close-out netting rights under an ISDA master agreement despite an obligor's insolvency?

While there is no indication that the Marshall Islands has adopted any version of the Model Netting Act of ISDA, it appears that close-out netting is enforceable in the Marshall Islands under general principles without the need for specific legislation. The current regime in the Marshall Islands is thought by some to be netting friendly, so, in the absence of any formal guidance, it is likely that close-out netting rights are enforceable.

UPDATE AND TRENDS

Current developments

- 50 | Are there any emerging trends or hot topics that may affect shipping finance law and regulation in your jurisdiction in the foreseeable future?

No significant trends or hot topics that are likely to affect shipping law or regulation in the Marshall Islands have come to our attention over the last 12 months.

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Coronavirus

- 51 | What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Following the implementation of covid-19 pandemic restrictions in early 2020, the Marshall Islands Maritime Administrator issued Marine Notice (1-004-3) and Marine Guideline (1-04-1) allowing additional flexibility in its usual recordation and acknowledgment requirements. Addressing the inability to host physical closings, the Registry made the following amendments to its usual procedural requirements: if a document needs to be acknowledged or notarised, this may be satisfied by electronic or remote means, and if an original document needs to be submitted, the Registry will accept electronic copies with the originals to follow. As a result, electronic or remote notarisation and acknowledgment have been allowed either by video conference, in which a special agent of the Registry is able to witness the live execution of the documents by the authorised signatory, or by electronic notarisation carried out by the authorised signatory's preferred notary agent. As a last resort, if none of these remote or electronic means are available, in certain circumstances the Registry has also allowed acknowledgment by a lawyer in good standing with his or her applicable bar association, law society or similar association. These adaptive modifications made in response to the pandemic have allowed registrations, recordations and other filings to function smoothly, and it is likely that the ability to notarise and acknowledge remotely may carry on after the covid-19 pandemic.

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