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SYMPOSIUM:
GOLDEN RULES: TULANE ADMIRALTY LAW INSTITUTE AND MARITIME LAW ASSOCIATION'S 50-YEAR REUNION

RECENT DEVELOPMENT

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The Last Half Century of Financing Vessels

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I. INTRODUCTION: THE CHANGING REALITIES

Changes in marine finance have been both evolutionary and revolutionary over the past fifty years. This Article will explore many

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of those changes from the past fifty years to the present and suggest how these changes have already influenced and might impact the future of marine finance.

While the costs per ton-mile to carry commodities by sea have in many cases declined,[1] the costs of modern ships have risen dramatically. Shipbuilding has migrated in large part away from Europe and North America to Asia. Within Asia these locations have shifted from Japan to Korea to China. The vessels delivered over the past fifty years have increasingly traded under flags of open registries and less frequently under the banners of traditional maritime nations.

Many traditional vessel operators have withdrawn from vessel ownership, and vessel ownership has experienced consolidation. New sources of capital, both equity and debt, have emerged. The classic marriage of closely held equity with traditional long-term bank debt has faded. Demand for capital has grown enormously to fuel the shipping industry growth to meet the demands of international trade. Resort to the public equity and debt markets has grown as shipowners have adapted to disclosure requirements for issuers, and capital markets have developed an appetite for shipping investment. Private equity firms have sponsored large, primarily equity investments in ships in tandem with professional ship managers, operators, and pools. New online lenders, aimed at smaller, more price-sensitive transactions, are preparing to move into ship finance.

Technological advances that have allowed exploitation of deep seabed oil reserves and greater capacity tanker operations also set the stage for heightened exposure to catastrophic oil pollution incidents. The governmental responses, both nationally and internationally, have resulted in greater liability risks to owners, operators, and investors, both passive and active. Casualties that once carried only the risk of loss of the investment now also may entail enormous liabilities to third parties for damage to natural resources due to strict liability statutes.

Finally, the primacy of national flags and of flag state policing of vessel conditions and operations has given way to a system dominated by sophisticated open registries and port-state control of transiting vessels. The role of classification societies has expanded, and the

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1. MARTIN STOPFORD, MARITIME ECONOMICS 73-80 (3d ed. 2009). Stopford indicates that "[o]ne of the contributions of shipping to the global trade revolution has been to make sea transport so cheap that the cost of freight was not a major issue in deciding where to source or market goods." *Id.* at 73.

need to contain liability exposure has spawned innovative insurance products and called for greater capital in the insurance and reinsurance markets.

Collectively, all of these developments have served to expand the variety of financing structures and fueled the length, density, and complexity of ship finance documentation. However, no development has displaced the special position of the ship mortgage.

II. THE SHIP MORTGAGE COMES OF AGE

A. Before 1966

Although the security device embodied in the preferred mortgage or hypothèque is still a fundamental feature of ship finance worldwide, the manner and scope of ship finance has been altered in many respects. A century ago, the preferred mortgage did not exist in the United States. Secured financing of vessels was confined to the narrow structures governing the validity of bottomry[2] and *respondentia* bonds,[3] including the concept that the loans thereby secured had to facilitate a specific voyage or cargo movement. It was not then possible to extend term or revolving credit to a shipowner for general purposes secured by a credible lien on the owner's vessels.[4] Congress changed this in 1920. In its creation of the "preferred mortgage" lien, the Ship Mortgage Act of 1920[5] revolutionized the financing of ships in the United States and elevated the mortgagee's lien position to a level vastly superior to that of a secured creditor in a land-based financing transaction. It was no longer necessary to connect the extension of credit to the application of proceeds to the liened vessel alone. All significant departures from the historical

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> The true definition of a bottomry bond, in the sense of the general maritime law, and independent of the peculiar regulations of the positive codes of different commercial nations, is, that it is a contract for a loan of money on the bottom of the ship, at an extraordinary interest, upon maritime risks, to be borne by the lender for a voyage, or for a definite period.

The Draco, 7 F. Cas. 1032, 1043 (C.C.D. Mass. 1835) (No. 4,057) (Story, J.).

3. "[The] *respondentia* bond takes the risk only of a total loss, that any part of the property which arrives goes to the holder of the bond, without regard to whether it be great or whether it be small, so that it does not exceed the amount of the loan." Ins. Co. v. Gossler, 96 U.S. 645, 657 (1877).

4. *See, e.g.*, Bogart v. *The Steamboat John Jay*, 58 U.S. (17 How.) 399, 401-02 (1854).

5. Ship Mortgage Act of 1920, ch. 250, sec. 30, 41 Stat. 988, 1000.

maritime lien law in the bottomry antecedents were confirmed and validated by the United States Supreme Court in its 1934 decision in *Detroit Trust Co. v. The Thomas Barlum*.[6]

The Court noted that: "While the Congress took care to make distinct provision for cases where a mortgage covers property other than a vessel, no distinction is made as to the status of mortgages of vessels by reason of an intention to devote the borrowed moneys to uses other than maritime."[7]

The Ship Mortgage Act of 1920 was preceded overseas by statutes in England allowing ship mortgages on U.K.-flag vessels[8] and by several laws in the civil law jurisdictions of Europe recognizing hypothecations, or pledges of vessels known as "hypothèques."[9] Each of these national laws was adopted to encourage investment in the national flag fleets of the adopting country.

A number of international attempts were made to harmonize the recognition of ship mortgages and their enforcement in foreign jurisdictions between 1920 and 1966, primarily at the instigation of the Comité Maritime International (CMI).[10] The International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages 1926 (1926 Convention) was the first of these.[11]

The 1926 Convention called for the recognition by all contracting states of any mortgage, hypothecation, or similar charge

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6. 293 U.S. 21 (1934).

7. *Id.* at 38.

8. The earliest of these was the Admiralty Court Act 1840, 3 & 4 Vict. c. 65 (1840) (Eng.).

9. *See* William Tetley, *Maritime Transportation*, *in* 12 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW: LAW OF TRANSPORT 1, 114 (Rolf Herber ed., 2001) (discussing related laws of France (1874), Portugal (1833), Prussia (1861), and Spain (1893)).

10. The CMI was formally established in 1897 to advance the unification of maritime laws. Its membership is composed of national maritime law associations, titulary and honorary members, and several other categories. From its founding until the 1960s, CMI partnered with the Belgian government in sponsoring a series of international conventions involving maritime law issues, many of which are still in force today. The advent of the International Maritime Organization (IMO) under the auspices of the United Nations largely has displaced, but not altogether limited, Belgium as the sponsor of such conventions. Nigel H. Frawley, *A Brief History of the CMI and Its Relationship with IMO, the IOPC Funds and Other UN Organisations*, CMI (Jan. 7, 2011), http://www.comitemaritime.org/Relationship-with-UN-organisations/0,27114,111432,00.html.

11. International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, Apr. 10, 1926, 120 L.N.T.S. 189 [hereinafter 1926 Convention].

placed on a vessel in another contracting state, provided the mortgage, hypothecation, or similar charge was "duly effected in accordance with the law[s]" of the state of registry of the vessel and was "registered in a public register either at the port of the vessel's registry or a central office."[12]

Additionally, the 1926 Convention called for recognition of five categories of liens and claims that would prime a mortgage: (1) court costs, (2) *custodia legis* costs, (3) crew wages, (4) salvage and general average, and (5) necessaries procured by the master while away from the vessel's home port.[13] This last category is at variance with modern statutes, including U.S. law,[14] which no longer recognizes vestiges of the "home port" doctrine[15] and sets liens for necessaries supplied in the United States above only foreign preferred mortgages for purposes of enforcement in U.S. Courts.[16]

The 1926 Convention was acceded to and ratified by twenty-eight states. It came into force on June 2, 1931. Norway, Denmark, Sweden, and Finland subsequently denounced the convention. The United Kingdom and the United States never ratified or acceded to the 1926 Convention.[17]

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12. *Id.* art. 1. This concept has also been reflected in U.S. law since 1954. Specifically, U.S. law recognizes as "preferred mortgages" enforceable in U.S. district courts,

> a mortgage, hypothecation, or similar charge that is established as a security on a foreign vessel if [it] was executed under the laws of the foreign country under whose laws the ownership of the vessel is documented and has been registered under those laws in a public register at the port of registry of the vessel or at a central office.

46 U.S.C. §§ 31301, 31325, 31326 (2012); *see also* Act of June 29, 1954, ch. 419, 68 Stat. 323 (amending the Ship Mortgage Act of 1920).

13. 1926 Convention, *supra* note 11, arts. 2-3.

14. 46 U.S.C. § 31301(5). Article 2 of the 1926 Convention, in part, recognizes a superior ranking for "[c]laims arising out of the contract of engagement of the master, crew and other persons hired on board." 1926 Convention, *supra* note 11. In 1993, the United States Court of Appeals for the Fifth Circuit interpreted this language and ruled that in the absence of any specific authority in the internal laws of the registry state, such language will be held to mean crew wages and not any social security payments. *See* Banco de Credito Indus. v. Tesoreria Gen., 990 F.2d 827, 838, 1993 AMC 2029, 2045 (5th Cir. 1993).

15. Under the "home port" doctrine, a ship's master could pledge the credit of the vessel to procure necessaries while away from the vessel's home port. However, creditors had access to the vessel's owners in the home port, making this device unnecessary. *See* Equilease Corp. v. *M/V Sampson*, 793 F.2d 598, 602, 1986 AMC 1826, 1832-33 (5th Cir. 1986).

16. 46 U.S.C. § 31326(b)(2).

17. *See* John M. Kriz, *Ship Mortgages, Maritime Liens, and Their Enforcement: The Brussels Conventions of 1926 and 1952*, 1963 DUKE L.J. 671. The next attempt at unification of the rules of priority and ranking of liens and mortgages resulted in the

In addition to the 1926 Convention, the International Convention Relating to the Arrest of Sea-Going Ships (1952 Arrest Convention) attempted to harmonize national laws governing which maritime claims can support the arrest of vessels by requiring Contracting States to recognize such claims as the basis for in rem proceedings in their national courts.[18] Maritime claims are defined in an enumeration of widely understood categories such as salvage, breach of charter hire obligations, cargo damage, bottomry, pilotage, and the like. The 1952 Arrest Convention defines the term to also include claims arising out of "the mortgage or hypothecation of any ship."[19] The 1952 Arrest Convention was entered into force on February 24, 1956. It was ratified or acceded to by a substantial number of Contracting Parties—eighty-one in all—but not the United States.[20] The 1952 Arrest Convention can be viewed as a success in many respects. In fact, many of its requirements reflect concepts recognized by non-Contracting States.[21]

International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages, some forty-one years after the 1926 Convention. CHRISTIAN L. WIKTOR, MULTILATERAL TREATY CALENDAR 1648-1995 849 (1998); *International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages*, ADMIRALTY & MAR. L. GUIDE, www.admiraltylawguide.com/conven/liens1967.html (last visited Mar. 9, 2017). The 1967 Convention recognized certain tort claims and port and canal dues as superior liens to mortgages, but then excluded necessaries claims from the list of superior liens. Only five States, Sweden, Denmark, Norway, Syria and Morocco, ratified the 1967 Convention, and it has never come into force. CMI YEARBOOK 2009 432, 476 (2009). Thereafter, through CMI efforts, the International Convention on Maritime Liens and Mortgages, 1993 was promulgated and came into force on September 5, 2004. International Convention on Liens and Mortgages, May 6, 1993, 2276 U.N.T.S. 39 [hereinafter 1993 Convention]. Ratified by only eighteen nations to date, it is not regarded as a success.

18. International Convention Relating to the Arrest of Sea-Going Ships, May 10, 1952, 1962 U.N.T.S. 195 [hereinafter 1952 Arrest Convention].

19. *Id.* art. 1(q).

20. CMI YEARBOOK 2009, *supra* note 17, at 462-64.

21. *See supra* text accompanying notes 12-13. Perceived shortcomings and limitations of the 1952 Arrest Convention have been addressed in the International Convention on Arrest of Ships, which came into force on September 14, 2011, having been ratified or acceded to by eleven Contracting States, not including the United Kingdom or the United States. International Convention on Arrest of Ships, Mar. 12, 1999, 2797 U.N.T.S. 3 [hereinafter 1999 Arrest Convention]; *International Convention on Arrest of Ships 1999 To Enter into Force in September 2011*, UNCTAD (Mar. 28, 2011), http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=366. The 1999 Arrest Convention recognized additional "maritime claims," including those for environmental loss or damage and also addressed the status of restraints such as the United Kingdom's MAREVA injunction, choice of law and *fora* for dispute resolution. 1999 Arrest Convention, *supra*, art. 1.1.

B. Forward From 1966: Efforts To Modernize the U.S. Regime

Fifty years ago, the preferred mortgage in U.S. law was only forty-six years old. Bills of sale and preferred mortgages were filed in various ports of documentation, each covering a specific geographic area of the vessel's home port. The U.S. Coast Guard was then under the U.S. Treasury Department, and for various historical reasons, the filing of instruments roughly followed the distribution of Customs districts in the United States. Recording was usually done by appointment, and in the case of preferred mortgages, the certificate of documentation was endorsed with the mortgage details. It was a slow, painful, and cumbersome process.

Since that time both U.S. law and processing of vessel registrations and mortgages have been improved. The most practical improvements were accomplished through the centralization of the registration functions at the Coast Guard's National Vessel Documentation Center (NVDC) in Falling Water, West Virginia, in 1994.[22] This move was done through the regulatory authority of the Coast Guard[23] but at the political behest of Senator Robert Byrd (D-W. Va.). All of the Port District Documentation Centers accordingly disappeared, save one in the U.S. Gulf which was continued for the convenience of the Gulf and inland marine operators.

The 1989 recodification of the ship mortgage laws (1989 Recodification) brought in a number of substantive changes to the law and jurisdiction over actions to enforce preferred mortgages in U.S. district courts.[24] This applies to preferred mortgages on U.S. documented vessels as well as equivalent mortgages on foreign-registered vessels foreclosed upon in the United States.[25] In particular, the amended section 225 of the Commercial Instruments and Maritime Liens Act (CIMLA) now allows nonadmiralty civil suits to be brought "against the mortgagor, maker, comaker, or guarantor for

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22. *U.S. Coast Guard National Vessel Documentation Center Centralization Update*, NAT'L TRANSP. LIBR. (Oct. 1995), https://ntl.bts.gov/DOCS/proc1095.html.

23. In 1983, Congress effectively granted the Coast Guard authority to determine where it would conduct its vessel registration functions: "Secretary [of the Department in which the Coast Guard is located] shall designate ports of documentation in the United States at which vessels may be documented and instruments affecting title to, or interests in, documented vessels may be recorded." Act of Aug. 26, 1983, Pub. L. No. 98-89, § 12113, 97 Stat. 500, 588.

24. Act of Nov. 23, 1988, Pub. L. No. 100-710, 102 Stat. 4735.

25. Bruce A. King, *Ships as Property: Maritime Transactions in State and Federal Law*, 79 TUL. L. REV. 1259, 1275-76 (2005).

the amount of the outstanding indebtedness or any deficiency."[26] More specifically, before the 1989 Recodification amendments, the pursuit of guarantors necessitated commencing an action in state court or in federal court if diversity of citizenship and the sufficient jurisdictional amount in controversy existed.[27]

Another significant change appeared in 46 U.S.C. § 31325(e), permitting the court to appoint a receiver to operate the arrested vessels in and out of the district court's territorial jurisdiction while allowing the court to retain jurisdiction over the vessels.[28] This subsection also cemented the superior jurisdiction of the federal courts in the arrest of vessels by explicitly providing that a U.S. marshal directed by federal court order may seize a vessel that is already "in the possession or under the control of a person claiming a possessory common law lien."[29]

Most significantly, the 1989 Recodification amendments updated the U.S. ship mortgage laws by opening the universe of potential mortgagees to foreign institutions, subject to certain narrow exceptions.[30] The 1989 Recodification also provided that preferred mortgages could secure revolving debt, contingent debt and obligations denominated in other currencies and alternating currencies.[31]

All in all, the 1989 Recodification was a culmination of years of concerted effort and thoughtful contributions by industry participants, most notably by the Marine Finance Committee of the Maritime Law Association of the United States (MLA). The Committee proposed language as well as reviewed and commented upon numerous drafts from congressional committees to make the mortgage provisions compatible with modern financing and funding techniques.[32]

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26. 46 U.S.C. § 31325(b)(2)(A) (2012).

27. *See* David McI. Williams, *A Comment on the Recodification of the United States Ship Mortgage Act*, 20 J. MAR. L. & COM. 153, 160-61 (1989).

28. 46 U.S.C. § 31325(e)(2).

29. *Id.* § 31325(e)(1).

30. Restrictions on eligible mortgagees were retained with respect to fishing vessels in the 1989 Recodification, and some were subsequently tightened further at the behest of Senator Theodore Stevens of Alaska, in efforts to stem foreign intrusion into the U.S. fishing industry. *Id.* § 31322(a)(4); American Fisheries Act, Pub. L. No. 105-277, § 202, 112 Stat. 2681, 2681-617 (1998) (codified as amended at 46 U.S.C. § 2101 (2012)).

31. 46 U.S.C. § 31321; *see also* H.R. REP. NO. 100-918, at 18 (1988) (recommending amendments).

32. Williams, *supra* note 27, at 154-55.

III. THE MOVE TO OPEN REGISTRIES

No development has had a more profound impact on marine finance over the past fifty years than the creation and expansion of open registries. Open registries are those ship registries which permit registration of vessels in a flag of a nation in which the registering owner is not a citizen or resident. In the mid-twentieth century, the prevailing view of international law held that there must be a "genuine link" between the citizenship of an owner and the flag of the ship. In the strictest interpretation of that concept, some thought that the link had to penetrate an owning entity to consider the citizenship of an entity's ultimate ownership. The United States and United Kingdom are closed registries, and the coastwise trade market in the United States is among the most restrictive.[33]

The actors and environment in the world of ship finance in 1966 differed markedly from today's picture. Fifty years ago, marine finance was largely the province of major U.S. and U.K. banks, along with some insurance companies and other capital sources thrown in.

Flags of Convenience or "open registries" were far less of a factor in 1966 than they are today. Indeed, some of today's major open registries were not then in existence, most notably the Marshall Islands.[34] The "national flags" or "closed registries" were the largest in terms of registered gross tonnage and numbers of ships in international trade. The U.K. Registry was the largest by tonnage until 1966, and the U.S. ocean-going tonnage was then fifth in the world. This common perspective fifty years ago is reflected in an article from the Chicago Tribune dated Sunday, July 3, 1966:

> LONDON, July 2—The British trading fleet, long the largest in the world, seems destined to lose its supremacy this year. Threatening Britannia's rule of the seas is the surging growth of shipping registered in Liberia.

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33. *See* George C. Kasoulides, *The 1986 United Nations Convention on the Conditions for Registration of Vessels and the Question of Open Registry*, 20 OCEAN DEV. & INT'L L. 543 (1989).

34. The Marshall Islands Registry was initiated in 1988. *About IRI*, INT'L REGISTRIES, INC., https://www.register-iri.com/index.cfm?action=about (last visited Mar. 6, 2017). Singapore formed its registry in 1966, Liberia in 1948, and Panama in 1925. *About SRS*, MPA.GOV, http://www.mpa.gov.sg/web/portal/home/singapore-registry-of-ships/about-srs (last visited Mar. 20, 2017); *Advantages of the Panamanian Registry*, CONSULATE GEN. PAN. LONDON, http://www.panamaconsul.co.uk/?page_id=115 (last visited Mar. 6, 2017); *History of Liberia's Maritime Program*, LIBERIAN REGISTRY, http://www.liscr.com/history-liberia%E2%80%99s-maritime-program (last visited Mar. 6, 2017).

> Growth projections of the small African nation's fleet—from virtually no ships after World War II to more than 10 million gross tons in 1958 and 19,332,000 tons in 1965—point to first place for Liberia by the end of the year among the world's merchant fleets of ships 599 gross tons and more.
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> . . . .
>
> The United States, not including its reserve fleet of 10,100,000 tons in "mothballs," ranks fifth with 9,931,000 tons. Norway is third with 15,589,000 tons, and Japan next with 11,250,000. The Soviet Union trails America with 7,455,000 tons.
>
> While Liberia will almost surely overtake Britain this year as the world maritime leader by this yardstick, it's [sic] ascendency will be largely statistical. Ship companies use Liberian registry as a "flag of convenience"—a guise to evade higher taxes and crew costs than if the vessels were registered in the shipowner's own country.
>
> United States companies use Liberian registry extensively—40 per cent of the Liberian fleet is estimated to be owned by Americans. [Among savings are the much lower crew costs. American seamen receive wages that are at least twice the scale in all other countries].
>
> Greek shipowners are thought to have a slightly higher percentage of Liberian registered vessels than United States companies, and the remaining 15 per cent is spread fairly well among the other leading maritime nations.
>
> . . . .
>
> Then, too, there is the fact that the Liberian fleet has a high percentage of oil tankers—less prestigious than the sleek passenger-cargo and cargo liners that characterize the British fleet.
>
> But even in the nontanker category, Liberia is creeping up in Britain's wake.
>
> In passenger service British lines continue to lead the world in the most heavily traveled routes, particularly the North Atlantic run. There, Cunard's proud [but aged] Queens Elizabeth and Mary carry more passengers than the ships of any other nation.[35]

To this point, the United Nations Convention on the Law of the Sea (LOS Convention) Article 91.1 provides:

> *Nationality of ships*
>
> 1. Every State shall fix the conditions for the grant of its nationality to ships, for the registration of ships in its territory, and for the right to fly its flag. Ships have the nationality of the State whose

35. Edward Rohrbach, *Predict U.K. To Lose Maritime Supremacy*, CHI. TRIB., July 3, 1966, at 4.

> flag they are entitled to fly. *There must exist a genuine link between the State and the ship*.[36]

The effect of the LOS Convention can be seen in the *M/V Saiga (No. 2)* case.[37] The International Tribunal for the Law of the Sea decided this case between Saint Vincent and the Grenadines and Guinea under the LOS Convention. The *Saiga* was registered and flagged in St. Vincent and the Grenadines and was seized by Guinea as an unregistered stateless ship for violations of Guinean law. Guinea argued that the seizure was lawful because there was no "genuine link" between the *Saiga* and the state of its registration and flag. Also, at the time of the seizure, the *Saiga*'s Provisional Registry Certificate had expired, and its Permanent Certificate had not yet been issued.[38] St. Vincent maintained that under its domestic law, a vessel was registered until deleted, regardless of the expiry of any certificate.[39]

The Tribunal found that a State Party could not condition its recognition of the nationality of a vessel based on its determination that a "genuine link" did or did not exist.[40] In doing so, the Tribunal examined the origins and intendment of the term "genuine link" as it first arose in section 5 of the Convention on the High Seas (1958 Convention).[41] The 1958 Convention addressed "genuine link" in similar terms:

> 1. Each State shall fix the conditions for the grant of its nationality to ships, for the registration of ships in its territory, and for the right to fly its flag. Ships have the nationality of the State whose flag they are entitled to fly. There must exist a genuine link between the State and the ship; in particular, the State must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag.
>
> 2. Each State shall issue to ships to which it has granted the right to fly its flag documents to that effect.[42]

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36. United Nations Convention on the Law of the Sea art. 91(1), Dec. 10, 1982, 1833 U.N.T.S. 3 (emphasis added).

37. *M/V Saiga* (No. 2) (St. Vincent v. Guinea), Case No. 2, para. 83, Judgment of July 1, 1999, http://www.itlos.org/fileadmin/itlos/documents/case/case_no_2/merits/Judgment.01.07.99.E.pdf.

38. *Id.* para. 58.

39. *Id.* para. 59.

40. *Id.* para. 183.

41. *Id.* paras. 80-81.

42. Convention on the High Seas art. 5, Apr. 29, 1958, 450 U.N.T.S. 11.

The Tribunal essentially construed the burden of "genuine link" as a requirement imposed on State members to exercise control without undermining the member States' rights to give effective national status to ships according to their own standards:

> The conclusion of the Tribunal is that the purpose of the provisions of the [1958] Convention on the need for a genuine link between a ship and its flag State is to secure more effective implementation of the duties of the flag State, and not to establish criteria by reference to which the validity of the registration of ships in a flag State may be challenged by other States.[43]

One might envision the chaos from a different construction of "genuine link" in modern shipping where open registries have displaced closed registries at such a rapid pace. The United Nations Conference on Trade and Development (UNCTAD) has chronicled the change in fleet registrations, including open registries, for many years now. As its statistics reveal, closed registry fleets have declined every year in modern memory while the overall inventory of vessels in international trade has expanded. As of July 1, 2008, three open registries—Panama, Liberia, and the Marshall Islands—accounted for approximately 42% of the global fleet.[44] The Marshall Islands alone has increased its registered fleet in excess of 13% since 2008.[45]

Fifty years ago, "genuine link" was already on its death bed as the Panama Ship Registry and the Liberian Ship Registry continued expansion of their open registry fleets both in terms of number of vessels and tonnage statistics. Still, fifty years ago, closed registry fleets boasted significant numbers of vessels in international commerce.[46]

Open registries offered shipowners low- or zero-tax environments, easy access to registry functions, and freedom from the burdens of national flag restrictions and requirements, including employment rules and higher costs of national labor.[47] The current

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43. *M/V Saiga* (No. 2) (St. Vincent v. Guinea), Case No. 2, para. 83, Judgment of July 1, 1999, http://www.itlos.org/fileadmin/itlos/documents/case/case_no_2/merits/Judgment.01.07.99.E.pdf.

44. UNCTAD, REVIEW OF MARITIME TRANSPORT 2015 ch. 2 (2015).

45. *Id.*

46. *See* Rohrbach, *supra* note 35.

47. *See generally* H. Edwin Anderson, III, *The Nationality of Ships and Flags of Convenience: Economics, Politics, and Alternatives*, 21 TUL. MAR. L.J. 139 (1996) (discussing vessel nationality and the creation of open registries); Kasoulides, *supra* note 33, at 445-55 (same).

dominance of open registries appears even more dramatically when measured not in terms of numbers of registered vessels, but instead by gross tonnage or deadweight capacity.

Significant Open Registries[48]			
	Number of Ships	GT	DWT
Antigua & Barbuda	992	8,628,343	11,121,727
Bahamas	1,141	52,483,094	67,553,798
Belize	250	1,575,549	2,371,258
Cayman Islands (British)	118	3,330,592	4,391,122
Cyprus	799	20,504,818	32,520,442
Denmark (DIS)	348	14,825,776	16,905,673
Gibraltar (British)	249	2,779,558	3,259,011
Hong Kong	2,238	101,389,102	165,588,980
Isle of Man (British)	311	13,578,155	21,948,545
Liberia	2,969	126,690,266	198,749,031
Malta	1,927	63,074,278	95,638,923
Marshall Islands	2,661	116,714,309	189,448,831
Norway (NIS)	362	13,037,031	17,206,155
Panama	6,156	212,367,784	324,589,815
Singapore	2,133	79,014,559	119,961,433
St Kitts & Nevis	121	800,410	1,070,825
St Vincent & The Grenadines	207	1,728,069	2,416,841
Vanuatu	74	978,872	1,536,063
Total—All Listed Foreign Open Registries	**23,056**	**833,500,565**	**1,276,278,473**
World Fleet Totals—ALL FLAGS	**41,674**	**1,139,012,950**	**1,704,512,742**
Open Registry—% of Total	**55.3%**	**73.5%**	**74.9%**

The decline of national flags is not better illustrated than in the United States. By 2014, the entire U.S. fleet of documented vessels

48. *Merchant Fleet by Flag of Registration and by Type of Ship, Annual, 1980-2016*, UNCTADSTAT, http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=93 (last visited Feb. 22, 2017).

numbered about 40,000. Of this amount, only eighty-five were engaged in international commerce between U.S. and foreign ports, which was down from 850 vessels thirty-five years earlier. The percentage of commercial cargo carried on U.S. bottoms declined from 25% of the global total to 2% between 1955 and 2014.[49]

Some criticized open registries, referring to them as flags of convenience, with ineffective protections for seagoing labor and thin regulatory infrastructures to assure safety.[50] Notwithstanding such criticisms, open registries have grown in the past fifty years at dramatic rates and increased in number, most notably by the creation of the Marshall Islands Ship Registry. This was only possible because financial institutions were willing and able to underwrite this phenomenon with mortgage-secured debt finance.

In doing so, the banks and other financial institutions lending into the open registry fleets had to first convince themselves of the viability, safety, and reliability of the open registries. This assurance came over time and with experience. In the case of the major open registries, each host nation (Panama, Liberia, and the Marshall Islands) derived substantial income from registration fees and tonnage taxes. This rise in income caused local politicians to refrain from interference in the registry, even during chaotic domestic circumstances—such as the bloody coup in Liberia led by Sergeant Doe in April 1980 and the corrupt interregnum led by Manuel Noriega in Panama from 1983 to 1989.[51]

Recently, reputational risk to the financial institutions has caused them to establish policies that govern which registry flags such lenders will finance. For that same reason, the leading open registries are zealous to avoid accepting substandard or overaged vessels into their registries. As UNCTAD remarked in recent years:

> Historically, when the first shipowners started to "flag out" by registering their ships in a foreign open registry in the 1970s or even earlier, one of the motivations may have been less stringent safety and environmental regulations. Today, there is no generalized difference between open and national registries as far as the ratification and implementation of relevant international conventions is concerned. A

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49. Memorandum from Staff, Subcomm. on Coast Guard & Mar. Transp. to Members, Subcomm. on Coast Guard & Mar. Transp. (Sept. 5, 2014).

50. *See* Kasoulides, *supra* note 33, at 544-46.

51. RICHARD COLES & EDWARD WATT, SHIP REGISTRATION: LAW AND PRACTICE 62 (2d ed. 2009).

> comparative table provided by the International Chamber of Shipping shows that both national and open registries can be found among the best and among the worst service providers . . . . The registries with youngest fleets among the top 35 flags were Hong Kong (China), the Marshall Islands and Singapore.[52]

Lenders also drew comfort from the legal systems in the open registries that created a hospitable environment for both shipowners and mortgagees. In Liberia and the Marshall Islands, the basic maritime legislation and regulatory provisions adopt the nonstatutory general maritime law of the United States.[53] The lawyers who drafted the laws of Liberia and the Marshall Islands therefore modeled the laws after the better features of U.S. law with various innovations. These innovations improve the nature of the mortgage security, permit the use and securing of new financial products, and avoid newly identified pitfalls.

Open registries by their nature might be said to represent what one author claims is "sovereignty for sale."[54] However, these open registries have shown no inclination to represent any sovereign interest other than commercial profit. Open registries do not subsidize their fleets, do not seek to project sovereign military or political power, and do not assert crewing citizenship requirements.[55] Sovereign hosts to open registries often have separate cabotage requirements for their domestic, in shore trades, but these are not consequential in international trade, for example, the U.S. coastwise trade or internal EU trade.[56] In this respect, financing open registry vessels for the most part poses less sovereign risk. Shipowners from more questionable jurisdictions can improve their financing prospects by working through an open registry platform.

No open registry jurisdiction has a credible legal infrastructure to address insolvency issues or reorganization in the shipping industry.[57]

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52. UNCTAD, *supra* note 44, at 41-43.

53. *See* The Maritime Act 1990, MI-107 § 113 (Marsh. Is.); The Liberia Maritime Law, 21 RLM-107 § 30 (1956).

54. RODNEY CARLISLE, SOVEREIGNTY FOR SALE: THE ORIGINS AND EVOLUTION OF THE PANAMANIAN AND LIBERIAN FLAGS OF CONVENIENCE (1981).

55. *See* Anderson, supra note 47, at 157-58.

56. *See generally Internal Market—Services (cabotage)*, EUR. COMMISSION: MOBILITY & TRANSPORT (Mar. 23, 2017), https://ec.europa.eu/transport/modes/maritime/internal_market/services_en (providing explanation of cabotage requirements).

57. This point may be proven by comparing the calculations of the World Bank, an international financial institution that provides loans to countries around the world and is part of the United Nations, calculations for the strength of various countries' insolvency

Given the ready access to *fora* in the United States and other jurisdictions, bankruptcy expertise in open registry jurisdictions seems unnecessary.[58] Proposals to create such infrastructure are routinely rejected as efforts to solve what is not a problem.

In terms of quality control, open registries typically rely on International Association of Classification Societies (IACS) members to determine the soundness and safety of vessels coming into and continuing in the registry, as well as to ensure compliance with international regulations.[59] This in fact is not much different from many national flags which contract out regulatory responsibilities to IACS members.[60] Despite the aspersions cast by some on the quality of open registry ships, the truth is most often a different story. As one leading expert has put it:

> To be successful an open register's ships must be acceptable in the ports of the world and to bankers lending against a mortgage on the ship. As the scrutiny of ships by shippers and port authorities has increased it has become more important for open register flags to comply with international conventions, and most open registries, whilst offering

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frameworks in a large number of jurisdictions on a scale of 0 to 16, with 16 being the highest score. World Bank rated the strength of the insolvency framework indexes in two U.S. cities, New York and Los Angeles, which are not open registry jurisdictions, to be 15/16. Even among sophisticated jurisdictions, it is worth noting that World Bank rated the United Kingdom to be 11/16. World Bank rated the strength of the insolvency framework index in Panama, an open registry jurisdiction, to be 6/16. Even more telling, World Bank rated the strength of the insolvency framework indexes in Liberia and the Marshall Islands, both open registry jurisdictions, to be 0/16. *Compare Resolving Insolvency in United States—New York City*, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/new-york-city/resolving-insolvency/ (last visited Mar. 20, 2017) *and Resolving Insolvency in United States—Los Angeles*, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/los-angeles/resolving-insolvency/ (last visited Mar. 20, 2017), *with* Resolving Insolvency in the United Kingdom, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/united-kingdom/resolving-insolvency/ (last visited Mar. 20, 2017); *Resolving Insolvency in Panama*, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/panama/resolving-insolvency/ (last visited Mar. 20, 2017); *Resolving Insolvency in Liberia*, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/liberia/resolving-insolvency/ (last visited Mar. 20, 2017) *and Resolving Insolvency in Marshall Islands*, WORLD BANK: DOING BUS., http://www.doingbusiness.org/data/exploreeconomies/marshall-islands/resolving-insolvency/ (last visited Mar. 20, 2017).

58. *See infra* subpart VII.B.

59. *See, e.g.*, *Classification Societies—Their Key Role*, IACS (June 2011), http://www.iacs.org.uk/document/public/explained/CLASS_KEY_ROLE.pdf; *see also* Kasoulides, supra note 33, at 546 ("[Open registry countries] have no interest in exercising responsible and effective control over vessel construction and operation, certification of personnel qualifications, crew training and social conditions.").

60. *See, e.g.*, 46 U.S.C. § 53102(b) (2012); 46 U.S.C. §§ 3316, 5107 (1988).

> shipowners freedom in the areas of taxation and company law, enforce legislation regarding the operational and environmental safety of ships registered under their flag.[61]

What, then, is this particular attraction of open registries to ship lenders? The need that open registries fill in international shipping is not unlike that which the Cape Town Convention attempts to provide to those seeking safety for security interests in mobile property, particularly aircraft.[62] These open registries, in varying degree, provide nonpoliticized registries governed by published, straightforward, commercially sensible statutory and regulatory provisions. The open registries have a reliable forum to file and record mortgage liens and a system of recordation administered with integrity. Moreover, rather than superimposing an international registration system often in duplication of national filing regimes, the open registries use practices, terminology, and principles familiar to the shipping industry for over a century.

Both the Marshall Islands Maritime Act of 1990[63] and the Liberian Maritime Law[64] contain provisions which adopt the "non-statutory General Maritime Law of the United States of America" as the general maritime law of their respective jurisdictions. In that way, questions of construction and interpretation are aided by the rich body of decisional law in the United States on questions which have never come before the courts of Liberia or the Marshall Islands. The courts can use these tools without impinging on the statutory distinctions between the United States and these open registries.

No national flag has a fleet of commercial seagoing vessels even approaching the size or quality of a number of open registry fleets. A lender familiar with the workings of the Panama, Liberian, and Marshall Islands international registries therefore has ease in lending into flags which together represent nearly half of the world's vessels trading internationally, by both numbers of seagoing ships and gross tonnage.[65]

Change comes slowly and unreliably from legislatures in countries with national registries. Looking at the United States, by

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61. STOPFORD, *supra* note 1, at 671.

62. Convention on International Interests in Mobile Equipment, Nov. 16, 2001, 2307 U.N.T.S. 285.

63. The Maritime Act 1990, MI-107 § 113 (Marsh. Is.).

64. The Liberia Maritime Law, 21 RLM-107 § 30 (1956).

65. UNCTAD, *supra* note 44.

way of example, it is quite clear that change in law can most often only be achieved with bipartisan support and with a strong constituency behind it, no vested interests against it, and no political value in derailing it for unrelated political purposes. One need only refer to the coastwise citizenship restrictions in U.S. law, commonly referred to as the Jones Act.[66] Efforts by the MLA to introduce financing charter provisions into U.S. law were met with either indifference or lobbying hostility from Jones Act interests. In contrast, legislative amendments based on these same principles were enthusiastically adopted in the Marshall Islands, which have since supported a number of charter financing transactions.[67] Further, similar legislative amendments are under consideration in Liberia.

This same dynamic is evident in many other areas. If a problem is perceived in current law or an opportunity identified in changing the maritime law in open registry jurisdictions, those jurisdictions try to respond to industry requests for amendments to the law. In the author's extensive experience, most are careful not to have this flexibility abused.

Examples of this flexibility are reflected in statutory amendments in open registries expressly recognizing newer financing structures and eliminating uncertainties about the effect of a preferred mortgage in securing them. Specifically, the maritime laws of the Marshall Islands and Liberia contain provisions allowing currency substitutions,[68] contingent debt,[69] revolving credit facilities,[70] and amounts coming due under financing charters.[71]

The ingenuity in shipping has also prompted the adoption of provisions in the maritime laws of the Marshall Islands and Liberia that permit the continuation of a prior foreign mortgage where pledged vessels are transferred between open registries, allowing for registration and domestication of an existing mortgage without loss of priority.[72] The need of shipowners to leverage the costs of building projects in Brazil was the impetus behind new provisions allowing

66. 46 U.S.C. § 30104 (2012).

67. *See* Francis X. Nolan III, *Financing of Vessels*, *in* 3 EQUIPMENT LEASING 34-35 ¶ 34.05(1) (2016).

68. 21 RLM-107 § 106B; MI-107 § 310.

69. 21 RLM-107 § 101(2); MI-107 § 303(1).

70. 21 RLM-107 § 106A; MI-107 § 309.

71. MI-107 § 302A.

72. 21 RLM-107 § 101(c)(3)-(4); MI-107 § 303(2).

documentation of "vessels under construction"[73] and allowing construction period loans to be secured by preferred mortgages on vessels under construction.[74]

At this writing, bareboat registry has been widely accepted and even recognized in passing by Congress in the legislative history of the 1989 Recodification of the Ship Mortgage Act.[75] Bareboat registry involves the registration of a vessel in State A and the temporary suspension of the owners' right to fly the State A flag for a limited period of time. During that time, State B allows a bareboat charterer of that ship to file the charter in State B and fly the flag of State B. Bareboat registry, which require enabling legislation in both the "outbound" and "inbound" jurisdictions, developed from the desire to fix the documentation of the vessel in a safe open registry, while also allowing temporary use of that vessel in privileged domestic trades of another jurisdiction.[76] The effect of this maneuver might allow the ship to take advantage of lower preferred bunker costs, preferential berthing, cargo availability, and other privileges without suffering the full political risk of State B vessel registration.[77]

When the concept of bareboat registry first surfaced in the 1970s, it was met with suspicion and concern that it was essentially "dual registry," the flying of two flags, which is deemed a violation of international law.[78] A number of financial institutions, on advice of counsel, proscribed the practice in their financing documents on collateral vessels.[79] Over time, lenders came to appreciate the difference between dual registry and bareboat registry, no doubt helped along by the increasing number of jurisdictions, both national flags and open registries, that accommodated the practice. Provisions were further honed to clarify that a mortgage must and need only be recorded in State A, the jurisdiction of the vessel registry, and not in

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73. MI-107 § 203(f).

74. *Id.* § 303(1).

75. Specifically, in clarifying the definition of "preferred mortgage," Congress noted that, "if a vessel is registered in one country, but is permitted to fly temporarily the flag of another country (such as through a demise charter), it is the law of the country in which the ownership of the vessel is documented that is used to determine when a mortgage attains preferred status." H.R. REP. NO. 100-918, at 37 (1988).

76. Ademun-Odeke, *An Examination of Bareboat Charter Registries and Flag of Convenience Registries in International Law*, 36 OCEAN DEV. & INT'L L. 339, 344-46 (2005).

77. Francis X. Nolan III, Recent Issues in Financing Vessels, American Law Institute, 133 ALI-ABA 345, 350 (1995).

78. *See id.* at 350-51.

79. *See id.*

State B, where only the bareboat charter is registered.[80] The practice of bareboat registry also gained respectability by reference to it in subsequent conventions.[81]

At first blush, it would seem that open registries have dispossessed traditional maritime nations of much of their shipping presence. This is not the case in all respects. The flags the world's internationally trading vessels fly are more usually open registries, and the crew compositions include fewer nationals of the traditional seafaring nations.[82] However, per a report circulated January 9, 2017, the United States is presently the fifth largest shipowning nation in the world by fleet valuation at more than $34 billion, the same relative position it was claimed to hold in 1966.[83]

IV. RECALIBRATING THE RISKS TO SHIP FINANCIERS

Fifty years ago, financial institutions structured ship finance transactions in many cases as leveraged leases, with some passive investors holding title, enabling them to utilize depreciation deductions and the investment tax credit. At the same time, the largest portion of the capital cost of new vessels (perhaps 76% to 80%) was financed with mortgage debt incurred by the title holder on

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80. MI-107 §§ 260, 264.

81. *See, e.g.*, United Nations Convention on Conditions for Registration of Ships art. 11, Feb. 7, 1986, 26 I.L.M. 1229; 1993 Convention, *supra* note 17. Article 16 of the International Convention on Maritime Liens and Mortgages provided, inter alia, that the State of Registration determines the recognition of registered mortgages, hypothèques, and mortgages. In addition, it indicated that no State Party shall permit flagging in unless all mortgages, hypothèques, and charges have been satisfied or the flagging out has been consented to in writing by the holders of those instruments. *See* 1993 Convention, *supra* note 17.

82. *See Foreign-Flag Crewing Practices*, U.S. DEP'T TRANSP. & MAR. ADMIN. (Nov. 2006), https://www.marad.dot.gov/wp-content/uploads/pdf/Crewing_Report_Internet_Version_in_Word-update-Jan_final.pdf.

83. *See* 46 U.S.C. § 31325(e)(1) (2012); Rohrbach, *supra* note 35; *Top 10 Shipowning Nations 2017*, WORLD MAR. NEWS (Jan. 9, 2017), http://worldmaritimenews.com/archives/209977/infographic-top-10-shipowning-nations/. The United States' ownership position in the world's ocean-going fleet has not been constant. With changes made in the tax treatment of foreign source income under the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, U.S. ownership decreased significantly, but it was thereafter restored as a result of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418. More recently, investments made by U.S. private equity in the markets has likely also contributed to the level of U.S. ownership. The effects of the two tax reforms cited herein indicate the very direct sensitivity of U.S. control of shipping to the policy changes.

a nonrecourse basis.[84] Then, as now, debt and equity investors were focused on the nature and degree of risks. Beyond the unpredictable economic risks that the marketplace might hold for the earning capacity of assets over time, there have always been political risks, risks of physical loss or damage, obsolescence, and the impact of changes in law. Some of these risks were mitigated by insurance products, such as hull, machinery, and war risks covers in the case of loss or significant damage and expropriation covers in the case of requisition of title.[85] Economic risks were often mitigated by requiring that long-term charters, preferably a bareboat charter to a financially solvent entity, be in place for most of the useful life of the ship. Beyond that, documentation was generally replete with conditions precedent, representations, warranties, covenants, events of default, and remedies for the borrower to ensure that the perceived risks were either avoided, mitigated, or adequately insured against. If the risks matured into a loss, the lender or investor was to be indemnified by the borrower.

While this same approach applies today, the risks to shipping investment have multiplied and deepened, resulting in a host of new insurance products, markedly expanded documentation, and a change in the mix of deal structures. Financiers in 1966 saw the risks in shipping to be the loss of all collateral and investment in the worst case. Since that time, risks to the financiers based on liability exposure have arisen, primarily with respect to environmental casualties.[86]

In 1966, the shore-based management of a shipowner did not have real-time control over vessel operations. As a consequence of this, a casualty at sea might be followed by a meaningful limitation of liability.[87] That result is no longer imaginable in the United States,

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84. The mortgagee's recourse in such transactions was typically to the vessel collateral and the assigned obligations of the bareboat charterer, but not to the registered owner personally.

85. *See* GRAHAM BARNES, THE BANKSERVE GUIDE: THE INSURANCE ASPECTS OF SHIPPING AND OFFSHORE FINANCING 16-21 (2016).

86. *See* Ingvild Ulrikke Jakobsen, *The Adequacy of the Law of the Sea and International Environmental Law to the Marine Arctic: Integrated Ocean Management and Shipping*, 22 MICH. ST. INT'L L. REV. 291, 292 (2013).

87. Following a casualty, a vessel owner's liability is limited to the value of the vessel and freights then pending, provided that the loss occurred without the privity or knowledge of the owner. 46 U.S.C. § 30505(a). Owners will still file limitation actions following casualties but usually to achieve the benefit of "concurrence," forcing all lawsuits

where strict owner liability overshadows concepts of negligence and unseaworthiness in environmental matters particularly.

While pollution from ships was very much a problem in 1966, the consequence of it was not what it has since come to be. Around this time, the average size and capacity of oil tankers in international trade grew to meet the oil boom and economic realities of the industry.[88] However, the 1960s did realize some consequences resulting from ship pollution. For example, on March 18, 1967, a recently jumboized, Liberia-flag tanker, *M/V Torrey Canyon*, broke up on Pollard's Rock off the coast of the United Kingdom, releasing its entire cargo of 119,000 tons of Kuwaiti crude oil into the Atlantic and onto the beaches of Cornwall, Guernsey, and Brittany.[89] The *Torrey Canyon* spill was history's largest oil spill at the time.[90] Because the British government fought with naval air bombardments and vast quantities of toxic solvents and dispersants, the ocean floor was littered with unexploded ordnance, and sea creatures large and small were killed off.[91]

In response to the Torrey Canyon disaster in the 1960s, the international community moved to regulate the construction and operation of oil tankers and to create funds to finance spill removal and compensate those affected economically by spills. This effort has continued both on the international level and on the national level in the United States.[92]

Moreover, concerted efforts were made shortly after this environmental disaster to fashion an international framework that could address other disasters of *Torrey Canyon*'s magnitude in the Inter-governmental Maritime Consultative Organization (IMCO).[93]

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into one federal court forum and not with any real expectation that the owner's liability will be limited.

88. René Taudal Poulsen, Hans Sjögren & Thomas Taro Lennerfors, *The Two Declines of Swedish Shipping*, *in* GLOBAL SHIPPING IN SMALL NATIONS: NORDIC EXPERIENCES AFTER 1960 100, 104 (Stig Tenold et al. eds. 2012).

89. Albert E. Utton, *Protective Measures and the "Torrey Canyon,"* 9 B.C. INDUS. & COM. L. REV. 613, 613-14 (1968).

90. It was estimated that global oil pollution per annum at the time was approximately 500,000 tons and that the *Torrey Canyon* spill equaled more than a fifth of the worldwide total. *See* THE TORREY CANYON: REPORT OF THE COMMITTEE OF SCIENTISTS ON THE SCIENTIFIC AND TECHNOLOGICAL ASPECTS OF THE TORREY CANYON DISASTER 3-4 (1967).

91. *See* 1 PLINIO MANCA, INTERNATIONAL MARITIME LAW 192-93 (1970).

92. *See, e.g.*, Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484 (codified at 33 U.S.C. §§ 2701-2762 (2012)).

93. IMCO changed its rather clumsy moniker to the International Maritime Organization (IMO) in 1982. IMCO was formed following a 1948 international conference

The CMI formed a Special Committee to consider these issues in May 1967.[94]

Some, including the U.S. delegation to the Special Committee, were of the view that the *Torrey Canyon* disaster was an isolated incident making special insurance requirements unnecessary.[95] Subsequent history disproved this view, as even larger tankers produced a series of dramatic oil spills around the world.[96]

Following this series of disasters at sea which resulted in oil discharges, contamination, loss of natural resources, and economic injury, the Oil Pollution Act of 1990 (OPA '90) was enacted in the United States,[97] and a series of oil spill conventions administered by the IMO came into being. These conventions include the International Convention on Civil Liability for Oil Pollution Damage of 1969 (CLC Convention), the International Convention for the Prevention of Pollution from Ships (MARPOL 73), and a series of updating protocols and annexes over the years to the present time. The CLC Convention imposed concepts of strict liability for those holding title to registered ships and owners of unregistered ships, for "loss or damage caused outside the ship carrying oil by contamination resulting from the escape or discharge of oil from the ship, wherever such escape or discharge may occur, and includes the costs of preventive measures and further loss or damage caused by preventive measures."[98]

"Ship" is defined in the CLC Convention as "any sea-going vessel and any seaborne craft of any type whatsoever, actually carrying oil in bulk as cargo."[99] The Convention applies, by its terms, "exclusively to pollution damage caused on the territory including the territorial sea of a Contracting State and to preventive measures taken

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in Geneva. *Brief History of IMO*, IMO (2017), http://www.imo.org/en/About/Historyof IMO/Pages/Default.aspx.

94. MANCA, *supra* note 91, at 15-16.

95. *Id.* at 224.

96. Among others, *Argo Merchant* spilled 28,000 tons of fuel oil and cutter stock off Nantucket Island in 1976; *Amoco Cadiz* discharged 223,000 tons of crude oil off the coast of Brittany, France in 1978; and *Exxon Valdez* grounded in Prince William Sound, Alaska, discharging 37,000 tons of crude oil in March 1989. *Case Studies*, ITOPF, www.itopf.com/ in-action-de/case-studies/ (last visited Feb. 17, 2017).

97. Oil Pollution Act of 1990, Pub. L. No. 101-380, 104 Stat. 484 (codified at 33 U.S.C. §§ 2701-2762 (2012)).

98. International Convention on Civil Liability for Oil Pollution Damage art. I.6, Nov. 29, 1969, 973 U.N.T.S. 3.

99. *Id.* art. I.1.

to prevent or minimize such damage."[100] The CLC Convention allows an owner to limit its liability for pollution damage to an amount calculated with reference to the ships tonnage, provided the incident causing the damage did not result from the "actual fault or privity of the owner."[101] OPA '90, on the other hand, is domestic legislation affecting any "vessel" or "facility"—not only sea-going ships—that discharges oil into the navigable waters of the United States.[102] It imposes strict liability on a statutorily designated "responsible party" for any unlawful discharge.[103] Responsible parties include, in the first instance, owners and operators of vessels and facilities.[104]

Further, MARPOL 73 and its successive protocols and annexes indirectly but significantly impose requirements on ships intended to improve their condition, construction, outfit, and operations for the purposes of reducing the likelihood of pollution. MARPOL 73 mandates that each contracting state impose the convention's requirements on ships that either fly its flag[105] or "operate under its authority."[106] MARPOL 73 defines ship as a "vessel of any type whatsoever operating in the marine environment and includes hydrofoil boats, air-cushion vehicles, submersibles, floating craft and fixed or floating platforms,"[107] and its application is therefore far broader than the coverage of the CLC Convention.

The *Torrey Canyon* had a much larger impact than its environmental consequences. After *Torrey Canyon*, oil spills were no longer simply inconvenient and unfortunate. They now resulted in civil and criminal penalties; quantifiable economic loss claims against owners, operators, and vessels; and the loss of a mortgagee's lien priority in vessels unlawfully discharging oil. Strict liability for owners and operators led to a general flight of oil companies from ownership and operation of tankers. Tanker ownership and flagging had already been migrating to the open-registry flags, excepting the world of mainly smaller tankers operating in protected cabotage trades under the Jones Act in the United States. Oil companies

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100. *Id.* art. II.
101. *Id.* art. V.2.
102. *See* 33 U.S.C. § 2702(a).
103. *See id.*
104. *See id.* § 2701(32).
105. International Convention for the Prevention of Pollution from Ships art. 3(1)(a), Nov. 2, 1973, 1340 U.N.T.S. 61.
106. *Id.* art. 3(1)(b).
107. *Id.* art. 2(4).

evolved into cargo owners and shippers transporting cargo under time charters, voyage charters, transportation agreements, and contracts of affreightment, but never as owners, disponent owners, or operators.[108] Fearing any taint of collusion in the use of substandard shipping, major oil companies set up the London-based Oil Companies International Marine Forum (OCIMF), which has created and sponsored the Ship Inspection Report Programme (SIRE) to vet vessels tendered for oil company hires.[109] This system features extensive application forms and procedures, requirements and review of vessel age, condition, equipage, operator experience, flag and crew quality, and experience. All of these changes to the way tanker ownership and operations are structured have resulted in extensive growth in the burdens imposed on shipowners by financing parties. At the same time, a successful vetting of a tanker under the SIRE program is essential to that vessel's value in the market place. Knowledgeable lenders often insist on at least one successful vetting of a tanker as a condition precedent to funding loans or make the absence of acceptance under SIRE an event of default.

There are many other requirements for a shipowner in addition to specific diligence obligations. Shipowners are also usually required to obtain not only hull and machinery, protection, indemnity, and mortgage interest policies, but also, in the case of tankers, policies of mortgagee interest (additional perils—pollution) to insure for the benefit of a mortgagee the loss of preferred mortgage liens in the event a priming maritime environmental tort lien swamps the vessel's value.[110] Similar policies have been developed to protect passive ship lessors from loss of interest and are generally referred to as "innocent owner policies."[111]

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108. *See* Inho Kim, *OPA 90 and the Decision To Own or Charter Tank Vessels*, 35 J. MAR. L. & COM. 219, 247 (2004).

109. According to the OCIMF website, SIRE

> was originally launched in 1993 to specifically address concerns about sub-standard shipping. The SIRE Programme is a unique tanker risk assessment tool of value to charterers, ship operators, terminal operators and government bodies concerned with ship safety. . . . Currently there are over 22,500 reports on over 8000 vessels for inspections that have been conducted in the last 12 months.

About SIRE, OCIMF (2017), https://www.ocimf.org/sire/about-sire/.

110. *See* BARNES, *supra* note 85, at 86-92, 116-121, 232.

111. *See* Stephen R. Kruft, *Insurance in Ship Leases*, *in* EQUIPMENT LEASING ¶ 10.04[2][f] n.39 (2016), Lexis.

OPA '90 was originally modeled on the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA).[112] As originally enacted, OPA '90 imposed strict liability on persons who hold title in "vessels" or "facilities" that discharge oil into navigational waters.[113] This liability was in most cases a show stopper for financial lessors. It was also a major concern for mortgage holders concerned about the impact of the statute on the mortgagee's freedom to exercise self-help remedies on default, such as repossession and redeployment of the vessel to earn income.[114]

The federal court decision in *Puerto Rico v. M/V Emily* S illustrates the effect of OPA '90, as originally written, on longstanding concepts in U.S. general maritime law.[115] The tug *M/V Emily S* was lease financed by Metlife Capital Corporation (Metlife) evidenced by a bareboat charter from Metlife to Bunker Group Inc. and New England Marine Services, Inc.[116] One night, an unmanned barge named *Morris J. Berman* discharged 750,000 gallons of oil into coastal waters after a towing cable parted and the barge ran aground.[117] The government argued successfully that the tug and an unmanned non-self-propelled barge formed a "single entity" and that the tug itself would be viewed itself as a discharging entity and thus as a "responsible party" under OPA '90.[118] The strict liability standards of OPA '90 were found to

> deviat[e] from the well-entrenched rule of general maritime law that allows an owner of a vessel to insulate itself from liability for the acts of a vessel or her crew by bareboat or demise chartering the vessel to another party, as [OPA '90] imposes joint and several liability on each person owning, operating or demise chartering the vessel.[119]

The *M/V Emily S* case added to the hypersensitivity of financial institutions to lending to tank vessels by lease or debt structures. Even lenders in debt structures had serious concerns about exposures to liability during or following foreclosure or other exercises of

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112. *See* Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767.

113. 33 U.S.C. § 2702(a) (2012).

114. *See About SIRE*, *supra* note 109.

115. 13 F. Supp. 2d 147, 1998 AMC 2020 (D.P.R. 1998).

116. *Id.* at 149 n.1, 1998 AMC at 2020 n.1.

117. Press Release, DOJ, Top Manager and Corporations Convicted in Puerto Rico Oil Spill Disaster (Apr. 25, 1996).

118. *M/V Emily S*, 13 F. Supp. 2d at 150, 1998 AMC at 2022.

119. *Id.*

remedies upon default of a mortgage. Consider also that secured lenders often protect their positions in foreclosure by "credit bidding," that is, bidding a portion of the lender's secured claim as consideration to purchase the property at auction, putting up cash only as required to pay off superior claims such as *custodia legis* and preferred maritime liens, in the case of vessels.[120]

In 2004, Congress amended OPA '90 by passing the Coast Guard and Maritime Transportation Act of 2004.[121] The amendments incorporated an exception to strict liability for lenders who hold title as security for a debt, the same as applied all along to situations covered by CERCLA. They accomplished this by expanding the definition of "owner or operator" of a vessel or facility, in the first instance, to exclude "a person that is a lender that, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect the security interest of the person in the vessel or facility."[122]

The amendments also addressed the plight of the foreclosing lender, but in a heavily qualified way:

> [A] person that is a lender that did not participate in management of a vessel or facility prior to foreclosure, notwithstanding that the person—
>
> (I) forecloses on the vessel or facility; and
>
> (II) after foreclosure, sells, re-leases (in the case of a lease finance transaction), or liquidates the vessel or facility, maintains business activities, winds up operations, undertakes a response action under section 9607(d)(1) of this title or under the direction of an on-scene coordinator appointed under the National Contingency Plan, with respect to the vessel or facility, or takes any other measure to preserve, protect, or prepare the vessel or facility prior to sale or disposition,
>
> if the person seeks to sell, re-lease (in the case of a lease finance transaction), or otherwise divest the person of the vessel or facility at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.[123]

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120. *See In re* Aéropostale, Inc., 555 B.R. 369, 414 (Bankr. S.D.N.Y. 2016) (defining credit bidding).

121. Coast Guard and Maritime Transportation Act of 2004, Pub. L. No. 108-293, § 703, 118 Stat. 1028, 1069-75 (codified at 42 U.S.C. § 9601-9675 (2012)).

122. 42 U.S.C. § 9601(20)(E)(i).

123. *Id.* § 9601(20)(E)(ii).

To some extent, this amendment has relaxed concerns about strict liability, but even to this day, a number of lease financiers are hesitant to finance tankers—at least tankers trading to the United States. Lenders appear to have grown comfortable with the effect of this amendment combined with the comfort of tighter insurance and indemnity covenants in shipping loan documentation as well as the impact of port state control and SIRE vetting of tankers.

V. THE SEARCH FOR ALTERNATIVE FINANCE

A. The Capital Markets

Fifty years ago, there were few, if any, public shipping companies. There were public companies that owned and operated ships, particularly in the oil and mining industries. The bulk of shipping, though, was privately and closely owned and operated in deeply secretive operations.[124] This posed three problems in expansion into modern times in which technology drove ever shorter obsolescence: (1) required capital investments for ship acquisitions were more significant; (2) the effective cost of capital for shipping was too great; and (3) liability exposures and compliance costs were vastly higher, while the shipowner equity base was shrinking.

To some extent, the answer to this need came in the expansion of available equity by public offerings in shipping IPOs in the 1990s and years following. The ability to tap the public equity and debt markets depended on a significant cultural evolution on the part of the world's shipowners—taking to heart the obligation to provide disclosure to satisfy requirements of U.S. securities laws. While the issuers came from all over the traditional shipping world, the IPOs and Private Placements were primarily and originally in New York. Further, most of the issuers were owners, directly or indirectly of open registry tonnage.[125]

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124. *See, e.g.*, Rose George, *Container Shipping: The Secretive Industry Crucial to Our Existence*, TELEGRAPH (Sept. 6, 2013, 7:00 AM), http://www.telegraph.co.uk/finance/newsbysector/transport/10289821/Container-shipping-the-secretive-industry-crucial-to-our-existence.html.

125. *See* Costas Th. Grammenos & Nikos C. Papapostolou, *Ship Finance: US High-Yield Bond Market*, *in* THE BLACKWELL COMPANION TO MARITIME ECONOMICS 418 (Wayne K. Talley ed., 2012).

B. The Rise of Specialist Shipping Banks

A complementary development to capital markets was the evolution of the German Landesbanks and Reconstruction Banks, founded originally to help finance the revival of industry and economy in Germany after the Second World War. In many cases, these banks grew from supporting German shipyards and shipowners to financing shipowners around the world. In modern times, these banks have been referred to as the "German Shipping Banks." These and a few Scandinavian banks have had, until very recently, an outsized presence in debt financing the world fleets, particularly European fleets. It has been estimated that at the writing of this Article, approximately 25% of the entire global volume of shipping loans are held by German banks.[126]

C. Private Equity Puts in its Oar

Following the general financial crisis of 2008, the availability of financing to shipping companies was constricted, and vessel values were depressed.[127] Raising funds in the public markets was not a practical possibility for most shipowners in that environment. Sensing opportunity in the depressed asset values in a key industry, a number of private equity firms stepped in to purchase and finance both existing vessels and undelivered and even uncompleted newbuildings, particularly in China and Korea.

Having access to private investment dollars but no industry knowledge or expertise, these firms typically paired up with reputable and established vessel managers and former shipowners on an 80/20 ownership basis to create equity investment vehicles to acquire vessels.[128] The acquisitions were financed either entirely by equity or by equity and debt.[129] The debt would be supplied by private equity

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126. Gary Dixon, *German Banks Have 25% of Global Shipping Exposure*, TRADE WINDS (Sept. 16, 2016, 7:42 AM), http://www.tradewindsnews.com/finance/778139/german-banks-have-25-percent-of-global-shipping-exposure.

127. *See* Thomas Schulz, *That Sinking Feeling: Global Crisis Hits Shipping Industry Hard*, SPIEGEL ONLINE (Dec. 5, 2008, 4:28 PM), http://www.spiegel.de/international/business/that-sinking-feeling-global-crisis-hits-shipping-industry-hard-a-594710.html.

128. *See* Mark Odell & Ajay Makan, *Wave of Private Equity Money Flows into Shipping*, FIN. TIMES (Oct. 27, 2013), https://www.ft.com/content/dadcb240-3d97-11e3-b754-00144feab7de.

129. *See* Alex Kyriakoulis & Holman Fenwick Willan, *Private Equity in the Shipping Industry: Barbarians at the Helm?*, FINANCIER WORLDWIDE MAG. (July 2014), https://www.

funds or from traditional shipping bank lenders willing to reengage on the basis of the balance sheet strength of the new investment vehicles. These new investment vehicles were particularly prominent in the drybulk and tanker spaces.[130]

Today, private equity has been more risk accepting and far more nimble than traditional banks. Private equity firms are not heavily regulated and are unfazed by growing reserve requirements or the need to take aggressive writedowns to satisfy government auditors. Private equity does have significant yield expectations, a great deal of which must have been disappointed in the recent market meltdowns in the drybulk market.[131]

Private equity by its nature tends to pass through industry sectors over periods of five years or less, taking advantage of undervalued assets and market dislocations. Nonetheless, private equity has served a significant function in supplying capital to the shipping industry, while traditional lenders have either disappeared or lost much of their appetite for new loans.[132]

The mix of capital available to shipping appears to be in flux with the ebbs and flows of availability from traditional and nontraditional sources as well as public markets. The documentation and structures of marine financing vary depending on the sources of the funds, the classification of the investment as equity or debt, and the institution's expectations for the sources of repayment or return. The ship mortgage remains a workhorse of ship finance, whether it secures a bank loan, guaranty obligations, bond debt, or otherwise.

D. Finance Leasing

Finance leasing has not been a strong player in the ship finance industry historically, but it has gained some ground as an alternative source in recent years. Finance leasing of other transportation assets has been a choice in the United States for some time and is probably the main method for financing aircraft and rolling stock in the United States. The different treatment of vessels is grounded in the historical

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financierworldwide.com/private-equity-in-the-shipping-industry-barbarians-at-the-helm/#.WNLbl5jruHs.

130. *See* Kyriakoulis & Willan, *supra* note 129; Odell & Makan, *supra* note 128.

131. *See* Monique Sinmao, *Alternative Finance Solutions: The Evolution of Ship Finance*, MARINE MONEY 13-14 (2016), https://www.marinemoney.com/sites/marinemoney.com/files/1.Ms_.%20Monique%20Sinmao.pdf.

132. *Id.*

development of ship finance through the device of the preferred mortgage, while financing of aircraft and rolling stock have been done by methods that recognize that a finance lease is a form of security agreement in which the lessor holds title for security purposes only.[133] To perfect lease-created security interests in the assets, aircraft leases may be filed with the Federal Aviation Administration (FAA) in Oklahoma City[134] and rolling stock with the Surface Transportation Board (STB) in Washington, D.C.[135] Until recently, the preferred mortgage has not been adapted to perfect a title holder's security interest in a leased vessel.[136]

The hazards of finance leasing of ships are well illustrated in a 2013 decision in the United States District Court for the Southern District of Texas, *Icon Amazing, L.L.C. v. Amazing Shipping, Ltd.*[137] In that case, plaintiff Icon Amazing was a finance company which entered into a sale and leaseback arrangement with defendant Amazing Shipping to refinance defendant's acquisition of the *M/V Amazing*.[138] The leaseback arrangement was done in the form of a bareboat charter on the Barecon 2001 form bareboat charter,[139] the commonly accepted starting point for such arrangements in international ship leasing transactions.

The court found that, despite the use of the Barecon form, the arrangement was in reality a secured financing and the "charter" in

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133. *See* Nolan, *supra* note 67, at 36-38 ¶ 34.05(2).

134. A recording system may be established for "(1) conveyances that affect an interest in civil aircraft of the United States." 49 U.S.C. § 44107(a) (2012).

135. The U.S. Code provides:

> A mortgage (other than a mortgage under chapter 313 of title 46), lease, equipment trust agreement, conditional sales agreement, or other instrument evidencing the mortgage, lease, conditional sale, or bailment of or security interest in vessels, railroad cars, locomotives, or other rolling stock, or accessories used on such railroad cars, locomotives, or other rolling stock (including superstructures and racks), intended for a use related to interstate commerce shall be filed with the Board in order to perfect the security interest that is the subject of such instrument.

49 U.S.C. § 11301(a).

136. *See* Press Release, Vedder Price, *First-of-its-Kind Legislation Known as the Maritime Amendment Act (No. 1), 2013 Passes* (Mar. 6. 2013), http://www.vedderprice.com/vedder-thinking/news/2013/03/firstofitskind-legislation-known-as-the-maritime-a [hereinafter *First-of-its-Kind Legislation*].

137. 951 F. Supp. 2d 909 (S.D. Tex. 2013).

138. *Id.* at 911.

139. *Id.* The Barecon 2001 form may be found on BIMCO's website. *See Barecon 2001*, BIMCO, http://www.bimco.org/contracts-and-clauses/bimco-contracts/barecon-2001 (last visited Feb. 17, 2017).

substance a security agreement.[140] The decision recited numerous features of the charter that resembled loan provisions.[141] Further, the court relied on repeated references by plaintiff in its term sheet and correspondence to the nature of the arrangement as a "loan" with "charter hire" computed with reference to principal and interest and defendant's option at each anniversary to purchase the vessel and its obligation to purchase the vessel at the end of the charter period.[142] This was classic recharacterization analysis in the United States. The court held that the owner was in reality a secured lender; the charter was not a true charter and therefore claims based on it were not maritime in nature and could not form the basis of a Rule B attachment of other property of defendant, thereby depriving the court of jurisdiction.[143] The *Icon Amazing* case illustrates the problems financial institutions face in finance leasing of any vessel traveling to the United States where it could be subject to arrest. In U.S. courts, they are neither true owners nor holders of perfected security interests.[144] This predicament is not the case generally overseas where the literal title of the governing document will determine its treatment by foreign courts. The analysis outside the United States would inevitably be that the person named as "owner" in a charter or what purports to be a charter will be treated as one.

This issue was addressed in a 2013 amendment to the Marshall Islands Maritime Act creating a class of "financing charters," which are bareboat charters intended as security that may be filed as preferred mortgages securing the claims of the owner, as a preferred mortgagee, against the charterer, as a mortgagor, to secure payment of hire, option, put, and termination payments.[145] Further clarifying amendments were enacted in September 2016.[146] To date, the Marshall Islands is the only jurisdiction to have passed such legislation, although similar changes are currently being entertained

140. *Icon Amazing*, 951 F. Supp. 2d at 917-18.
141. *See id.* at 912-14, 917.
142. *See id.*
143. *Id.* at 917-18.
144. Kemp Indus., Inc. v. Safety Light Corp., 857 F. Supp. 373, 385 (D.N.J. 1994).
145. Maritime (Amendment) Act (No.1) 2013, Pub. L. 2013-5 (codified at The Maritime Act 1990, MI-107 § 302A).
146. Maritime (Amendment) Act 2016, Pub. L. 2016-14, § 201 (codified at The Maritime Act of 1990, MI-107 § 302A).

by the Liberian congress.[147] Both the Marshall Islands law and the Liberian bill are byproducts of a project undertaken by the Marine Finance Committee of the MLA, which drafted model legislation for amendments of U.S. law to permit this device, but the model legislation drew no interest from the U.S. Congress.[148] As of December 31, 2016, there have been thirty-two transactions completed under the Marshall Islands law in New York, Hamburg, Seoul, and Shanghai.[149]

Leasing appears to be a favored method of financing in Asia. Moreover, Chinese financial leasing has expanded substantially just over the past couple of years with the easing of certain regulatory restrictions by the Chinese Banking Regulatory Commission.[150] Leasing generally offers financing from 75% to 100% of the capital cost of a new vessel and a term of twelve years, as compared with perhaps a 60% advance rate on a commercial bank loan with a term of five to seven years at the time of this writing.[151] Chinese lessors are reportedly holding the entire exposure and leaving any syndication risk out of the equation.[152]

The largest ship leasing finance portfolio in 2015 among the Chinese lessors belonged to ICBC Financial Leasing Co., at $7.69 Billion in asset value including 272 vessels.[153] The mix of vessels and lessees reveals a base of non-Chinese consumers of Chinese leasing, including BP Shipping, Vale of Brazil, Mediterranean Shipping Company, Teekay, and Viking Cruises.[154] All of the vessels leased to the foregoing ICBC customers are registered in open registries.[155]

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147. *See* Chris Preovolos, *Ship Finance: Good News for the New York Deal Crowd*, SEATRADE MAR. NEWS (Mar. 6, 2013), http://www.seatrade-maritime.com/news/americas/ship-finance-good-news-for-the-new-york-deal-crowd.html.

148. *See First-of-its-Kind Legislation*, *supra* note 136.

149. *See* Nolan, *supra* note 67, at 45-46 ¶ 34.05(8).

150. Andrew Oates, *The Rise of Chinese Financial Leasing*, MARINE MONEY 51-52 (Jan. 2017), https://www.marinemoney.com/sites/marinemoney.com/files/pdf/MMMag_2017_01_RiseofChineseFinancialLeasing.pdf.

151. *Id.* at 51-52.

152. *Id.* at 53.

153. *Id.* at 55.

154. *Id.*

155. *See, e.g.*, *Ship Finance: Chinese Leasing Companies' More Prominent Role*, HELLENIC SHIPPING NEWS (Sept. 30, 2016), http://www.hellenicshippingnews.com/ship-finance-chinese-leasing-companies-more-prominent-role/; *CMES Injects USD 382 Mn in ICBC's Valemax Owner*, WORLD MAR. NEWS (May 30, 2016), http://worldmaritimenews.com/archives/193296/cmes-injects-usd-382-mn-in-icbcs-valemax-owner/; Angela Yu, *ICBC Leasing Issues USD200 Million Shipping Bonds*, FAIRPLAY (Feb. 25, 2016), http://fairplay.ihs.com/commerce/article/4262981/icbc-leasing-issues-usd200-mil-shipping-bonds; *Markets—*

Whether this expansion will be sustained is hard to tell for lessors beholden to political masters as much as the vagaries of the marketplace.

It is hoped that a wider use and acceptance of finance lease protections as presently in place in the Marshall Islands will ameliorate the Asian financier's risk that its leased vessels would be subject to arrest while trading to the United States, with the lessor unprotected as a secured lender.

E. FinTech Arrives

According to *Time*, "Financial technology companies (known collectively as FinTech) are broadening access to a range of services . . . that were once almost exclusively the business of banks."[156] These companies use technology and innovative services to bypass more traditional financial institutions.[157] Singapore-based Alpha Assets claims to be the first FinTech company servicing shipping exclusively and focusing on middle-market, single-ship financing transactions, a subsector of shipping left behind by the traditional shipping banks in recent years.[158] Alpha Assets invites shipowners to apply online and begin the process by inputting an IMO Number which triggers a standard diligence review by Alpha. The average transaction size is less than $10 million and the borrower is required to enter a suite of standard form mortgage loan documents. These documents vary only by the limited choice of applicable law and vessel registry, with a view to closing in less time than a traditional bank loan transaction and with little to no negotiation. Alpha sources its funds from a variety of investors, including by Regulation D fundraising in the United States, appropriate foreign methods outside the United States, family offices, and others. An investor or its representative can review a borrower's application and Alpha's diligence analysis online and then the investor may elect

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BP Signs Sale and Leaseback Deal, TANKEROPERATOR (Oct. 26, 2015), http://www.tankeroperator.com/news/markets--bp-signs-sale-and-leaseback-deal/7087.aspx; Luke Lyu, Vice President, Shipping, ICBC Financial Leasing Co Ltd., Presentation for Marine Money Forum, *Leasing as an Alternative for Shipping Finance* (Oct. 15, 2014), https://www.marinemoneyoffshore.com/sites/marinemoneyoffshore.com/files/Lyu.pdf.

156. Patricia Hart, *Banks Are Right To Be Afraid of the FinTech Boom*, TIME (Dec. 12, 2016, 11:15 AM), http://time.com/3949469/financial-technology-boom/.

157. *Id.*

158. Sinmao, *supra* note 131.

online if it wishes to fund and for how much. In this way, Alpha is a sort of clearing house for borrowers and credit sources.[159]

Whether FinTech is a successful approach to finance smaller- and middle-market shipowners remains to be seen. However, the sources of ship finance are ever more diffuse and will drive the need for rethinking the way in which ship finance transactions are protected.

VI. CHANGES IN HOW SHIP FINANCIERS VIEW REMEDIES

Generally speaking, ship lenders have a variety of remedies in contract, in admiralty, under national statutes and, in some cases, pursuant to international conventions. In every case, the source of the mortgagee's rights are found in the statutes in force in the registry jurisdiction.[160] The extent of remedies permitted for the mortgagee on default will depend in part on what is authorized and what is qualified or prohibited under the laws of the flag.[161]

However, the exercise of remedies against the vessel or the borrower will be dependent on the law of the forum where the mortgagee seeks to enforce its mortgage lien in almost every case.[162] The current iteration of the U.S. Ship Mortgage Act specifically establishes jurisdiction in federal courts for in rem actions against mortgaged vessels and in personam actions against mortgagors.[163]

A. Classic Foreclosures

Problems have persisted over the years with regard to the practical effects of foreclosure. For example, under U.S. law, judicial sale of a vessel by an Article III federal court sitting in admiralty serves to clear off all liens and claims in rem against the vessel.[164] Such a sale gives a buyer at auction the comfort of knowing that no liens or claims arising prior to the sale can thereafter be asserted against the vessel. As a result, prospects of a sale at a price somewhat reflective of the vessel's value are improved to the benefit of the lien

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159. Saravana Sivasankaran, CEO, Alpha Assets, Remarks at 355 Panel—New Sources of Credit for Shipping, 29th Annual Marine Money Week (June 21, 2016).

160. 46 U.S.C. §§ 31301-343 (2012); MI-107 § 316; 21 RLM-107 § 105.

161. Willard v. Wood, 164 U.S. 502, 520 (1896).

162. 46 U.S.C. §§ 31301-343.

163. *Id.* § 31325; *see supra* text accompanying note 24.

164. Goldfish Shipping, S.A. v. HSH Nordbank AG, 377 F. App'x 150, 153-54 (3d Cir. 2010).

creditors, particularly any mortgage lien holder. Without the availability of a judicial sale, the financier's exit strategy would be severely compromised.

Judicial sale procedures are available in most jurisdictions to a greater or lesser extent and with varying degrees of expedience, reliability, and integrity. Experienced ship financiers are aware of which jurisdictions are most suitable, including for example Rotterdam, Antwerp, Curaçao, Hong Kong, Singapore, and the United States.[165]

From time to time, complications have arisen as a buyer at an auction attempts to register his purchase at a new registry but finds himself unable to obtain a certificate of deletion from the prior registry where the vessel was documented at the time of judicial sale. Under many domestic statutes and customary international law, a vessel may not be registered in more than one state, thus making the deletion certificate from the prior jurisdiction indispensable to the buyer's entry into the new registry.[166]

The case of *Goldfish Shipping, S.A. v. HSH Nordbank AG* illustrates the problems a buyer may encounter following its purchase at auction.[167] In *Goldfish Shipping*, a German shipping bank commenced an in rem action against a Turkish-flag vessel in the United States District Court for the Eastern District of Pennsylvania for default of a loan facility.[168] The vessel was sold at auction and purchased by unrelated third parties who then provisionally registered the vessel in Panama. In order to complete permanent registration on a new registry, buyers needed to obtain evidence of deletion from the Turkish registries. The Turkish registry refused to issue a deletion certificate without a document from the German bank releasing its mortgage.[169] The German bank refused to provide the release

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165. *See* Nolan, *supra* note 67, at 68-68.1 ¶ 34.09(6).

166. *See, e.g.*, United Nations Convention on Conditions for Registration of Ships art. 11, Feb. 7, 1986, 26 I.L.M. 1229. As of February 18, 2017, this convention has been ratified or acceded to by fifteen nations and is unlikely to come into form since forty nations are required. *See id.* art. 19; *United Nations Convention on Conditions for Registration of Ships*, UN TREATY COLLECTION, https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XII-7&chapter=12&clang=_en (last visited Feb. 18, 2017). Notwithstanding, this convention reflects commonly accepted international principals concerning deletion and registries.

167. No. 07-3518, 2008 U.S. Dist. LEXIS 93135 (E.D. Pa. Nov. 3, 2008), *motion denied*, 623 F. Supp. 2d 635 (E.D. Pa. 2009), *aff'd*, 377 F. App'x 150 (3d Cir. 2010).

168. *See Goldfish Shipping*, 2008 U.S. Dist. LEXIS 93135, at *1-2, *10.

169. *See id.* at *3.

purportedly relying on advice that doing so would discharge the Turkish owner's liability for the deficiency owed to the German bank.[170] At the same time, the Turkish owner caused the vessel to be arrested first in Spain and then in Italy.[171] In each case, the court dismissed the arrests based on the effect of the judicial sale in Philadelphia, but only after the new owners had suffered losses by delays.[172]

The new owners sued the German bank claiming it had an obligation, as seller at auction, to do whatever was necessary to allow buyers to acquire the vessel "free and clear."[173] The district court sided with the mortgagee in finding that the U.S. marshal—and not the mortgagee bank—was the seller and that the foreclosing mortgagee had no obligation to release its mortgage. The result was upheld by the United States Court of Appeals of the Third Circuit.[174]

An Irish court arrived at a similar result in 2012 in *SPV Sam Dragon Inc. v. GE Transportation Finance (Ireland) Ltd.*[175] *Sam Dragon* was a Korean registered vessel mortgaged to a South Korean company, Samsun Logix Corporation.[176] Mortgagee foreclosed on the vessel in Ghent, Belgium, and she was sold at auction.[177] Mortgagee refused to discharge its mortgage of record in Korea on grounds similar to those asserted by the mortgagee bank in *Goldfish Shipping*.[178] The Irish court sided with the mortgagee, accepting evidence of Korean law that the mortgagee had no obligation to release its mortgage with deficiency amounts unpaid.[179]

The U.S. court in *Goldfish Shipping* and the Irish court in *Sam Dragon* both confirmed that the underlying judicially ordered sales resulted in the buyers acquiring the vessel free and clear of liens and that the ensuing difficulties with deletion certificates were not the obligation of the foreclosing mortgagee.[180]

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170. *See id.* at *6-7.

171. *See id.* at *7; *see also* FRANCIS X. NOLAN III, 10-4 BENEDICT'S MAR. BULL. (2013), LEXIS.

172. *Goldfish Shipping*, 2008 U.S. Dist. LEXIS 93135, at *1, *22.

173. *Id.* at *11.

174. *Goldfish Shipping*, 377 F. App'x 150 (3d Cir. 2010).

175. [2012] IEHC 240 ¶¶ 41-45 (Ir.).

176. *See id.* ¶ 2.

177. *See id.* ¶ 4.

178. *See id.* ¶ 5.

179. *Id.* ¶¶ 41-45.

180. *Id.*, ¶¶ 41-45; *Goldfish Shipping, S.A. v. HSH Nordbank AG*, 377 F. App'x 150, 153-54 (3d Cir. 2010).

These situations are not uncommon. Certain open registries have conformed their practices on registrations of vessels following judicial sales to allow evidence of the sale to suffice in resolving concerns about the termination of the prior registration. CMI formed an International Working Group on Judicial Sales of Ships (Judicial Sales IWG) to address these and related concerns.[181] The Judicial Sales IWG concluded its report, and a draft convention was approved by the general assembly of the CMI in June 2014 in Hamburg, Germany. The Judicial Sales Convention was presented to IMO in 2016,[182] but has not yet gained traction.

The *Goldfish* and *Sam Dragon* cases point to remaining significant issues to be resolved in the realm of ship mortgage financing and enforcement.

B. Ship Financiers as Bankruptcy Tourists

Shipping lenders have had an uneasy relationship with bankruptcy and insolvency proceedings for a variety of legal and cultural reasons. Since early in the history of the United States, the rehabilitation of debtors in reorganization proceedings has been a policy preference.[183] This is reflected in the U.S. Bankruptcy Code and its preference for reorganization, where possible, before liquidation.[184] In many other cultures, public shaming, stocks in the public square, and asset dismemberment are preferred. The effect of this instinct is to render ineffectual some European attempts to implement their own reorganization statutes as alternatives to U.S. bankruptcy proceedings in recent years.[185]

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181. The Judicial Sales IWG has provided commentary on the second draft of the Instrument on International Recognition of Foreign Judicial Sales of Ships. *Commentary on the 2nd Draft of the Instrument on International Recognition of Foreign Judicial Sale of Ships*, CMI (2012), http://www.comitemaritime.org/Uploads/Judicial%20Sales/Judicial%20Sales%20of%20Ships%20-%20Commentary%20on%20Second%20Draft.pdf.

182. CMI YEARBOOK 2015 279 (2016) (discussing Agenda Item 11 submitted by China, the Republic of Korea, and the CMI on March 31, 2016).

183. *See* DAVID A. SKEEL JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 48 (2001).

184. *See* Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship, 507 U.S. 380, 389 (1993).

185. *See* Insolvenzgesetz [Insolvency Statute], Oct. 5, 1994, BGBL 1 at 2866, as amended by art. 19 of the Act of Dec. 20, 2011 BGBL 1 at 2854, http://www.gesetze-im-internet.de/englisch_inso/; Council Regulation 2015/848, 2015 O.J. (L141) 19 (EU); Council Regulation 1346/2000, 2000 O.J. (L160) 1 (EU).

Successful bankruptcy reorganization of an international shipping enterprise is challenging for a number of reasons. Generally speaking, ship assets can be dispersed geographically around the globe, susceptible to arrest, seizure, or detention. Further, receivables can also be scattered and subject to a variety of defenses and offsets in collection.

U.S. bankruptcy courts are better suited than most to deal with international cross-border bankruptcies given their assertion of worldwide jurisdiction over the debtor's assets, broad definitions of debtor assets under U.S. law, and availability of extraordinary equitable remedies.[186] However, participation in a U.S. bankruptcy proceeding is expensive, enforcement of U.S. bankruptcy court orders in certain foreign jurisdictions can still be problematic, and many non-U.S. ship financial institutions have historically been distrustful of U.S. proceedings, instead preferring to seize collateral where it is found.[187]

With the recent increase in U.S. bankruptcy filings based on minimal U.S.-based asset requirements, the preferences of ship lenders have been preempted.[188] Consequently, in a number of cases, ship lenders have engaged with debtors to enter into reorganization proceedings with preagreed plans of reorganization, known as "prepacks," often resulting in a quick, orderly, and less costly reorganization.[189]

In a further development, amendments to the U.S. Bankruptcy Code introducing procedures for ancillary proceedings in support of

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186. *See* Samuel L. Bufford et. al., INTERNATIONAL INSOLVENCY 13-18 (Fed. Jud. Ctr. 2001).

187. *See* Van C. Durrer II & Chris Mallon, *European Restructuring Strategies: Chasing Ch. 11*, LAW360 (Jan. 24, 2012, 3:59 PM), https://www.law360.com/articles/302895/european-restructuring-strategies-chasing-ch-11.

188. *See In re: Marco Polo Seatrade BV*, No. 1:11-13634 (Bankr. S.D.N.Y. Nov. 3, 2011) (denying motion to dismiss international reorganization proceeding of a Netherlands-based shipping company and stating the minimum asset threshold for qualifying for Chapter 11 protection may be satisfied with reference to, among other things, deposit accounts and retainers in the United States, even where these deposits and retainers are solely related to U.S. bankruptcy counsel); Timothy A. Davidson II & Joseph Rovira, *United States: International Shipping Companies Successfully Navigate Chapter 11 with Prenegotiated Plans of Reorganization*, MONDAQ (June 26, 2014), http://www.mondaq.com/unitedstates/x/323378/Insolvency+Bankruptcy/International+Shipping+Companies+Successfully+Navigate+Chapter+11+With+Prenegotiated+Plans+Of+Reorganization; Stephen Drury & Jasel Chauhan, *Chapter 11—Liberation or Suspended Sentence*, MARINE MONEY OFFSHORE, http://www.marine-money.com/archive/chapter-11-%E2%80%93-liberation-or-suspended-sentence (last visited Mar. 24, 2017).

189. *See* Stephen D. Zide, P. Bradley O'Neill & Stephen M. Blank, *Prepackaged Bankruptcy: Is It Right for Your Company?,* 34-10 AM. BANKR. INST. J. 30, 31 (2015).

foreign main insolvency proceedings—known as Chapter 15s—have resulted in an increased number of actions commenced in the United States by foreign trustees to protect a debtor's U.S.-based assets.[190]

There has also been occasional talk overseas about the possibility of sponsoring an equivalent or improved version of the U.S. Bankruptcy Code in open registry jurisdictions like the Marshall Islands or Liberia. The motivation behind these efforts has always been anticipated lower costs. The main obstacle to such a development is the fact that there is already a long and highly developed body of law, regulation, and usage in U.S. bankruptcy, as well as a substantial cohort of U.S. practitioners and judges to make it work. The United States is also geographically more accessible and able to host a greater number of participants. As a result, the United States holds somewhat of an international franchise in reorganization proceedings, much like London claims for marine insurance or arbitration.[191]

Finally, while an open registry can perform registry functions through contractors outside the flag country—as many in fact do—it is not feasible to administer a judicial function outside the sovereign flag country's borders.

The evolved advantages of the U.S. Bankruptcy Code and its practices, the dominance of the U.S. capital markets in public shipping finance, and the active involvement of U.S. investment advisers in the shipping space have effectively invoked U.S. bankruptcy proceedings to affect international shipping to a degree unimaginable a mere fifty years ago.[192]

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190. *See* Peter M. Gilhuly, Kimberly A. Posin & Adam E. Malatesta, *Bankruptcy Without Borders: A Comprehensive Guide to the First Decade of Chapter 15*, 24 AM. BANKR. INST. L. REV. 47, 48-49, 104 (2016).

191. *See* Oscar Couwenberg & Stephen J. Lubben, *Corporate Bankruptcy Tourists*, (Working Paper Nov. 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2458044; Stephen J. Lubben, *Corporate Bankruptcy Tourists Land in U.S.*, N.Y. TIMES (Oct. 31, 2014, 10:06 AM), https://dealbook.nytimes.com/2014/10/31/corporate-bankruptcy-tourists-land-in-u-s/.

192. *See* Rick Hyman, Charles S. Kelley & Michael F. Lotito, *Shipping Company Bankruptcies: Impact of US Law on International Lenders and Other Non-US Creditors,* MAYER BROWN (June 9, 2014), https://www.mayerbrown.com/files/uploads/Documents/PDFs/Article-Shipping_Bankruptcies.pdf; *see also supra* note 57.

VII. THE CHANGING FACE OF GOVERNMENT SUPPORT

A. The U.S. Title XI Program

The most time-honored support for shipping is the mercantilist device used by sovereigns to lock out other flags from the privilege of carrying cargo into, out of, or within the sovereign's domains.[193] This was said to be a linchpin of the British Empire.[194] From the founding of the United States, domestic trade was restricted to U.S.-flag vessels built in the United States and was regarded at all times as a legitimate means to support national defense while promoting domestic manufacturing.[195] Other methods have been employed over time, including cargo reservation laws in common carriage liner trades[196] and preference for military and USAID cargo,[197] by way of example.

U.S. laws thus created a vacuum in certain trades by excluding foreign-flag carriers and foreign-built vessels. The purpose was to stimulate domestic interests to fill the vacuum. Over time, fewer and fewer U.S.-built and U.S.-flagged vessels were introduced to fill the void, and Congress responded with affirmative supportive measures under the Merchant Marine Act of 1936 and later amendments to the Act in 1970.[198] This legislation instituted subsidies for shipbuilding, vessel operations, and provisions for tax-deferred capital construction accounts to shelter income from vessel operations for future qualified vessel investment.[199] All of these provisions were intended to place U.S.-flag operators on par with their major international competitors. In doing so, Congress likely believed it had served the requirements of all the major constituencies: shipbuilders, ship operators, seagoing labor, and cargo interests—although perhaps not the American taxpayer.

To further enhance the fortunes of the U.S.-flag fleet, Congress also set up the federal loan guaranty program, commonly known as Title XI,[200] which intends to lower the effective capital cost of ship

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193. *See* Wm. W. Bates, *Our Maritime Reciprocity Conventions Examined in Detail*, 16 PROTECTIONIST 81, 82 (1904).

194. *See id.*

195. *See* 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES 518-19 (1833).

196. *See, e.g.*, Merchant Marine Act of 1970, Pub. L. No. 91-469, 84 Stat. 1018.

197. *See* Murray A. Bloom, *The Cargo Preference Act of 1954 and Related Legislation*, 39 J. MAR. L. & COM. 289, 289-90 (2008).

198. *See id.*; 46 U.S.C. §§ 1101-1279 (1936).

199. 46 U.S.C. §§ 1151, 1152, 1154 (1970).

200. 46 U.S.C. §§ 53501-517 (2012).

acquisition for the U.S.-owned and -flagged foreign trade fleet by inserting the federal government as debt guarantor for up to 87.5% of the capitalized costs of vessel acquisitions. The debt holders then have recourse against a sovereign obligor and the government secures itself with a preferred mortgage from the vessel owner as well as proceeds of the vessel collateral. The program allowed the United States acting through the United States Maritime Administration (MARAD) to issue guarantees in amounts which were multiples of the appropriation based on the common banking assumption that even in difficult business cycles, not all chickens will come home to roost and certainly not all at the same time.

Title XI was expanded to cover offshore mobile rigs and then vessels operating in the coastwise trade.[201] In 1993, Title XI was further expanded to allow the financing of newly built or rebuilt vessels for export.[202]

As with many governmental benefit programs, Title XI was subject to political pressure which overbore sound credit policies resulting in several bad experiences with defaulted debt. When grain export markets dried up in the mid-1980s, the hopper barge market collapsed, catching many passive investors as well as MARAD in bad circumstances.[203] A number of investors who had led partnerships as general partners with full recourse liabilities themselves went bankrupt, defaulting on numerous Title XI bond and note issues. Congress was forced to make supplemental appropriations to cover the Title XI Guaranty calls.[204]

Title XI has also been plagued with bureaucratic procedures and delays, burdensome documentation requirements, and congressional uncertainties as to appropriations and authorizations.[205] While it cannot be said that Title XI has no value, it has not been the force in ship finance that it conceptually could have been.

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201. *See id.* § 53701.

202. *Id.* § 53732.

203. *See Weaknesses in MARAD's Management Controls for Risk Mitigation, Workforce Development, and Program Implementation Hinder the Agency's Ability To Meet its Mission*, OFF. OF INSPECTOR GEN. AUDIT REP. (Dec. 10, 2015), https://www.oig.dot.gov/sites/default/files/MARAD%20Management%20Controls%20Final%20Report_12-10-15.pdf.

204. *See* Memorandum from Staff, *supra* note 49.

205. *See id.*

B. Foreign Governmental Support

There are a number of ways that foreign governmental agencies and sovereign banks have supported the shipping industry. However, this support has not followed the flag of the vessel or the domicile of the vessel owners. Dominance in vessel ownership no longer resides in North American or European national fleets, but rather in the open registries of Panama, Liberia, the Marshall Islands and others.[206] It would appear that the open registries have no means or motivation to subsidize acquisition, ownership, or financing of vessels and no apparent policy concerns about vessel and crew availability in time of war.

Instead, as the registration of vessels has moved to open registries, the financial stimulus support has in more recent times come almost exclusively from export credit agencies (ECAs) and related institutions in the nations supporting the construction of vessels for export—primarily, but not exclusively—Japan, Korea and China.[207] These include the Korea Export Import Bank (Kexim), China's Sinosure, and Japan's NEXI. Unlike MARAD in the United States, these ECAs are not tasked with protecting their nation's flag participation or seagoing labor. The financing products these ECAs sponsor range from countersecurity for shipyard refund guaranties to postdelivery loan guaranties and, in some cases, even guaranties of residual values.[208] It would seem likely as a matter of logic that the availability of these products has contributed to the superheated oversupply of vessel capacity in recent years, particularly in the drybulk and perhaps also the containership sectors.

VIII. OPEN ISSUES: THE "SHIP" OR "VESSEL" AS COLLATERAL

A number of issues continue to plague the world of ship finance, particularly in the realm of enforcement of remedies.

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206. *See* Anderson, *supra* note 47, at 140.

207. *See* Kevin Oates, Managing Dir., Marine Money Asia Pte. Ltd, Address at the 27th Marine Money Week (June 2014), https://www.marinemoney.com/sites/all/themes/marinemoney/forums/MMWeek14/presentations/Marine%20Money%20Academy/930%20AM%20Kevin%20Oates.pdf.

208. *See* Cho Kyu-Yeol, Exec. Dir., Export-Import Bank of Korea Presentation for Korea Eximbank, ECA Roles in Global Ship Finance (Nov. 1, 2012), https://www.marinemoney.com/sites/all/themes/marinemoney/forums/KOR12/presentations/1135%20Kyu-yeol%20Cho.pdf.

The ship mortgage, in its various forms, is a legislative creation incorporated into the laws of individual registry states.[209] As a rule, each jurisdiction permits imposition of a preferred mortgage on property that that jurisdiction defines as a "ship" or "vessel." This generally requires that the ship or vessel be registered or documented under the laws and flag of the jurisdiction.[210] As has been noted and widely understood, the terms "vessel" and "ship" have long been used interchangeably and each one often employed to define the other.[211]

In the United States, a preferred mortgage is defined as a mortgage that "covers a documented vessel" or "covers a vessel for which an application for documentation is filed that is in substantial compliance with the requirements of chapter 121 [of title 46 of the U.S. Code]."[212] The term "vessel" is itself defined for this and most other purposes in title 1 of the U.S. Code in the following terms: "The word 'vessel' includes every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water."[213]

To support a U.S. preferred mortgage, a craft not only had to meet the foregoing definition but also had to be documented with the NVDC of the U.S. Coast Guard.[214] To be documented as a U.S. vessel, a vessel must be at least five net tons[215] and be owned by citizens of the United States,[216] a requirement that varies by the nature of the owner from individuals to a range of entity formats.

Liberian maritime law permits registration of "[a]ny sea-going vessel of more than 500 net tons engaged in the foreign trade, wherever built, owned by a citizen or national of Liberia."[217] A preferred mortgage may be granted on a Liberian vessel and Liberian Maritime Regulations require the mortgage to recite the official number of the documented vessel.[218] Liberian maritime law does not

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209. *See* Francis X. Nolan, III & Marjorie F. Krumholz, *Navigating Your Lease Through a Sea of Liens*, L.J. NEWSL.—EQUIPMENT LEASING NEWSL., July 2008.

210. *See* 46 U.S.C. § 31322(a)(3)(A) (2012); 1993 Convention, *supra* note 17, art. 1(a).

211. 1 BENEDICT ON ADMIRALTY § 162 (2016), Lexis.

212. 46 U.S.C. § 31322.

213. 1 U.S.C. § 3.

214. *See* 46 U.S.C. § 31225.

215. Provisions for establishing tonnage measurement of vessels are laid out in the U.S. code and can vary for different purposes. 46 U.S.C. §§ 14101-307.

216. *Id.* § 12103(b).

217. The Liberia Maritime Law, 21 RLM-107 § 51(2) (1956).

218. *Id.* § 57(2).

itself define the term "vessel," although the qualifier of "sea-going" should serve to eliminate a host of marginal watercraft. Liberian law does, however, include a provision adopting the nonstatutory general maritime law of the United States, "[i]nsofar as it does not conflict with any other provisions" of the Liberian maritime law.[219] The Marshall Islands Maritime Act contains a similar provision adopting the general nonstatutory maritime law of the United States.[220]

Over the last fifty years, the energetic passage of domestic legislation and international conventions has imparted into the maritime world a wealth of special purpose definitions of the terms "vessel" or "ship," in many cases to define the object of legislation in specific terms and to refine the commonly understood terms. An obvious example of this appears in recent IMO fund conventions in which the term "ship" excludes a vessel when it is not then carrying oil or when it is not engaged in international waters.[221]

Some countries confine the scope of the term "ship" to seagoing vessels of a certain size, distinguishing larger from smaller craft and recognizing property such as mobile offshore drilling units (MODUs) as another species of maritime property.[222] Another issue arises when the use of the property changes, whether temporarily or permanently, as in the deployment of Liquefied Natural Gas (LNG) vessels as floating storage units or floating gasification or liquefaction facilities.[223]

The mortgage lender craves certainty in its documentation and a firm embrace of the collateral and prices loans with the understanding that its mortgage will be valid and enforceable against the collateral in the event of a loan default. This means that the lender must have certainty under the laws of the registry state that the pledged property collateral will be eligible for registration and mortgaging during the entire term of the loan. The lender must also be comfortable in its belief that wherever the collateral travels in the world it will be recognized as a proper subject of such a mortgage and that the mortgage will thus be enforceable in foreign courts. That is to say, by

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219. *Id.* § 30.

220. The Maritime Act 1990, MI-107 § 113 (Marsh. Is.).

221. Protocol to Amend the International Convention on Civil Liability for Oil Pollution Damage art. 1.1, Nov. 27, 1992, 1956 U.N.T.S. 255.

222. *See* Responses to First Questionnaire, *CMI International Working Group on Vessel Nomenclature* (on file with author).

223. *See* Brief for the MLA as Amicus Curiae Supporting Respondent at 10-11, Lozman v. City of Riviera Beach, 133 S. Ct. 735, 2013 AMC 1 (2013) (No. 11-626).

way of example, a mortgagee of a mobile rig registered in the United States or Marshall Islands and moved to another jurisdiction has to know that its mortgage would be enforceable in the courts of that jurisdiction.

By the same token, the mortgagee of an LNG tanker needs to know whether its mortgage will still be valid and the tanker still a vessel if the tanker is put to use as a storage facility or is put in long-term or indefinite cold layup. Consider, for example, recent trends to convert existing vessels for use as floating storage and regasification units (FSRUs), given the overcapacity in the gas carrier sector and the much higher cost of FSRU newbuildings compared to the cost of conversion of existing vessels.[224] In the absence of certainty on the tanker's status and eligibility for its registry, the mortgagee will have to forbid such alternative uses or layup, a result which is not necessarily in the best economic interest of any party to the financing.

These concerns have come to the forefront in recent years in part due to decisions of the U.S. Supreme Court, first in *Stewart v. Dutra Construction Co.*[225] and then in *Lozman v. City of Riviera Beach*.[226] Prior to *Stewart*, courts had always implicitly recognized the "existential vessel," that is to say, the intrinsic physical object as a vessel, while at the same time holding that the object must be "in navigation" to be the focus of admiralty jurisdiction.[227] In *Stewart*, the Court left this undistinguished and referred instead only to a determination of what is a "vessel," conflating the notion of a "vessel in navigation" with the concept of "vessel" itself.[228] The *Stewart* decision construed 46 U.S.C. § 3 in such a way as to implicitly import the operational practices of the dredge under consideration into the statutory definition that refers to capability as an alternative to actual use.[229] This unfortunate analytical short hand was extended by the Court in its 2013 decision in *Lozman*, in which the majority held that nothing in the "design" of the craft suggested that it was "intended" for transportation over water.[230] The results in *Stewart* and *Lozman* are

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224. *See, e.g.*, *Floating LNG Regasification Is Used To Meet Rising Natural Gas Demand in Smaller Markets*, U.S. ENERGY INFO. ADMIN. (Apr. 27, 2015), https://www.eia.gov/todayinenergy/detail.php?id=20972.

225. 543 U.S. 481, 2005 AMC 609 (2005).

226. 133 S. Ct. 735, 2013 AMC 1 (2013).

227. King, *supra* note 25, at 1289-90.

228. *See* 543 U.S. at 496, 2005 AMC at 609.

229. *Id.* at 490-91, 2005 AMC at 609.

230. 133 S. Ct. at 739, 2013 AMC at 5-6.

unlikely to discommode the maritime tort law, but they have raised concerns in the world of marine finance, at least where the finance of more marginal watercraft are concerned.

The source of these and related concerns arise from the fact that, in the 1989 Recodification, what had been regarded as multiple and unnecessary duplicative statutory definitions of the term "vessel" were winnowed out of title 46 of the U.S. Code, leaving one reference to 1 U.S.C. § 3 for nearly all purposes. Once that was accomplished, resolution of the meaning of the term in tort cases now fixes the wagon for marine financing as well. The variability and uncertainty in the conclusion of whether a vessel is a vessel now affects the world of ships mortgages.

In the case of conversion of ships to floating facilities or storage in long-term layup, the mortgagee must now reckon with regulatory interpretations of 1 U.S.C. § 3 that hold, for example, a vessel is deemed permanently withdrawn from navigation—and hence no longer a vessel—if it is connected to land-based utilities requiring more than eight hours to disengage.[231]

The most practical way to bypass these issues would probably be to devise a particular definition of "vessel" for purposes of documentation, mortgaging, and enforcement of U.S. and foreign preferred mortgages in U.S. federal courts. However, even if U.S. law were clarified in such a way for financing and mortgage enforcement purposes, the problem remains that the enforcement of mortgages is often required in jurisdictions outside the United States where definitions are often different with respect to certain types of vessels.

Following its conference in Istanbul in 2015, CMI created an International Working Group on Vessel Nomenclature (Vessel Nomenclature IWG) to determine the extent and impact of the definitional differences from jurisdiction to jurisdiction in defining "ship" and "vessel" and to recommend any appropriate course of action.[232] In early 2016, CMI circulated a first questionnaire[233] to the

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231. Craft Routinely Operated Dockside, 74 Fed. Reg. 21,814, 21,814-16 (May 11, 2009).

232. *See* CMI Ad Hoc Committee on Vessel Nomenclature, *Report Given to CMI Assembly Istanbul 2015 Colloquium*, CMI, http://www.comitemaritime.org/Uploads/Work%20In%20Progress/CMI%20Ad%20Hoc%20Ship%20Nomenclature.pdf (last visited Apr. 6, 2017); *"Ship" Nomenclature*, CMI, http://comitemaritime.org/Ship-Nomenclature/0,27154,115342,00.html (last visited Apr. 6, 2017).

233. *See* Letter from Stuart Hetherington, President, Comité Mar. Int'l, to Presidents, NMLAs (Mar. 8, 2016), http://www.comitemaritime.org/Uploads/Work%20In%20Progress/

CMI membership seeking input on these issues, to which nine national maritime law associations (NMLAs) have responded as of April 10, 2017.[234] Their responses already indicate a wide range of approaches to defining and qualifying the terms "ship" and "vessel" for different purposes under their respective laws. There is also a divergence among the respondents as to whether their national courts would allow seizure and foreclosure proceedings against property which their courts do not recognize as "vessels" or "ships" when such property is registered as a vessel in another flag jurisdiction.[235] Some NMLA's believe their courts would follow the flag state's view,[236] and others believe that their courts would not allow such foreclosure processes for lack of jurisdiction over the subject matter in the forum state.[237]

As to most seagoing, self-propelled vessels, there will not be disagreement over whether or not their physical characteristics qualify them for seizure, arrest, foreclosure, and application of other statutes and conventions. However, the concern remains as to floating property at the margins of the traditional maritime world, some of which can be expensive equipment moved to locations in the world where the rights of the mortgagee are less certainly recognized.

IX. CONCLUSIONS

The way ships are financed continues to evolve in response to a number of factors. The increasing importance of international trade, the input of national politics, and the enormous capital requirements

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Ship%20Nomenclature/Ltr%20to%20Presidents%20re%20IWG%20on%20Vessel%20Nomenclature%20-%20080316.pdf.

234. The countries that have responded are Brazil, Croatia, Denmark, Hong Kong, Ireland, Italy, the Netherlands, and Poland.

235. *Compare The Croatian Maritime Law Association Response to the CMI Questionnaire on Vessel Nomenclature*, CROATIAN MAR. LAW ASS'N (Apr. 14, 2016), http://comitemaritime.org/Uploads/Work%20In%20Progress/Ship%20Nomenclature/Croatia%20CMI%20Questionnaire%20on%20Vessel%20Nomenclature%20-%20Response%20of%20Croatian%20MLA.pdf (responding that Croatian courts will respect and apply other jurisdiction's definitions of "vessel"), *with Response of the Irish Maritime Law Association,* IRISH MAR. LAW ASS'N (Mar. 2016), http://comitemaritime.org/Uploads/Work%20In%20Progress/Ship%20Nomenclature/Irish%20Maritime%20Law%20Association's%20Response%20to%20IWG%20on%20Vessel%20Nomenclature%20-%20Finalised.pdf (responding that Irish courts would categorize the vessel in terms of domestic law).

236. The countries that believe their courts would follow the flag state's view are Croatia and Poland.

237. The countries that believe their courts would not allow foreclosure processes for lack of jurisdiction over the subject matter in the forum state are Hong Kong and Ireland.

of modern ships all conspire to challenge shipowners and those who seek to finance the industry. The past fifty years have shown in many ways how the practice of ship finance has attempted to react to and cope with these developments.

Open registries have become a highly successful way to give shipowners and mortgage lenders a neutral platform to forge a rational structure devoid of national politics. In the case of environmental challenges underscored by a series of oil spill catastrophes involving ever larger tank vessels, shipowners and financiers adopted new structures and elicited new insurance products to mitigate the extraordinary risks of pollution liability.

However, challenges remain for the parties to ship finance. The sources of funding, as profoundly as they have already changed over the past fifty years, will continue to evolve. It is unclear whether many current shipping bankers will remain in this business and whether private equity will take profits or lick the wounds of their losses and move on to their next theater. Will FinTech ride to the rescue of the middle-market owner? How the foregoing plays out will no doubt give rise to the need for new documentation and enforcement processes.

While the ship mortgage has been a critical ingredient in the financing of modern fleets, there remain many issues among and within nations' legal systems in the reciprocal recognition and enforcement of that security device.

Finally, the future of the ship mortgage and ship financing generally will require new and original legal thinking firmly grounded in the concepts of admiralty practice and maritime law as those have evolved over the centuries, while also recognizing the different approaches of civil law jurisdictions to the concept of hypothecation of maritime property. Harmonization, if not complete uniformity, of the availability of remedies in ship foreclosure around the globe would have a beneficial impact on the cost and volume of capital available to the shipping industry.