

Ship Finance

Contributing editor
Lawrence Rutkowski



2018

GETTING THE
DEAL THROUGH

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Ship Finance 2018

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Lawrence Rutkowski
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Preface

Ship Finance 2018

Fifth edition

Getting the Deal Through is delighted to publish the fifth edition of *Ship Finance*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

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

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

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

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

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

GETTING THE 
DEAL THROUGH 

London
June 2018

Marshall Islands

Francis X Nolan III and Ji Woon Kim

Vedder Price PC

Due diligence

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

Marshall Islands law establishes requirements for the vessel owner to demonstrate and affirm the facts of direct ownership of a vessel coming into the Marshall Islands flag. These requirements do not address ultimate or intermediate tiers of ownership, such as identification of parent entities in ownership structures.

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

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

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

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

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

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

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

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

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

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

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

All Marshall Islands corporations are empowered to guarantee the obligations of others unless specifically limited in the Business Corporation Act (BCA) or in the articles of incorporation of the corporation (BCA, section 15(g)) provided it is in furtherance of its corporate purposes. If that is not the case, or is in doubt or simply to avoid any issue in that regard, BCA section 16 allows a corporation to issue a guarantee, regardless of whether it is in furtherance of its corporate purposes, by obtaining the affirmative vote of a majority of the outstanding shares in the corporation at a shareholders' meeting. The same procedure can be used to authorise the corporation to secure the guarantee with a grant of a security interest in corporate property (BCA, section 16).

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

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

Repayment

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

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

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

Section 132 of the Maritime Act specifically provides that 'a Preferred Mortgage may secure such interest, including interest on interest, on an obligation secured by the mortgage as the parties may agree'. This provision is based on a similar provision in the US Ship Mortgage Act. Bearing in mind that few Marshall Islands-flagged vessels in foreign trade are arrested and foreclosed upon in the Marshall Islands itself, it will generally fall to the jurisdiction where a vessel is arrested to foreclose a preferred mortgage to determine whether this section 132 would be enforceable or against public policy in the place of arrest. We know of no reported cases where a court has upheld a usury defence in the face of provisions such as section 132 of the Maritime Act.

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

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

Registration of vessels

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

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

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

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

12 Who may register a vessel in your jurisdiction?

Under the Maritime Act, a vessel may be documented if owned by a citizen or national of the Marshall Islands or by a foreign maritime entity qualified in the Marshall Islands. Entities formed under the Associations Law (including the BCA) are considered nationals. A qualification as a registered foreign maritime entity is achieved under Division 13 of the BCA. Essentially, these provisions allow foreign entities, otherwise empowered under their home jurisdictions to own vessels, to apply, register and then document Marshall Islands-flagged

vessels. The Maritime Act and its implementing Maritime Regulations require applicants to provide information on the nature and powers of the entity, its legal representatives, its address and principal place of business, management and similar data. As a practical matter, the threshold for qualification is not significant and numerous Marshall Islands vessels are documented in the names of qualified foreign maritime entities.

13 Is there an alternate registry for international shipping operations?

The dominant registry in the Marshall Islands is the open international registry. Chapter 2 of the Maritime Act governs the registration and mortgaging of vessels in foreign trade. This registry dwarfs the purely domestic vessel registry in the Marshall Islands, which is regulated by the Marshall Islands Domestic Watercraft Act (see question 11). The international registry requires that the owner of a Marshall Islands vessel be a Marshall Islands entity (Maritime Act, section 203), but imposes no citizenship requirements on the ownership of such an entity. Moreover, the law was amended some years ago to permit ownership directly in Marshall Islands vessels by qualified foreign maritime entities.

Ship mortgages and other liens over vessels

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

The Marshall Islands follows the American model of ship mortgage, unifying the essential features of a mortgage grant with the covenants, representations, warranties, events of default and other provisions. While there are requirements to establish a preferred mortgage, there is no required form as such. A Marshall Islands preferred mortgage is flexible enough to secure any obligation of the mortgagor debtor. A preferred mortgage may secure a term loan, future advances and contingent obligations, including guaranties, swap obligations and other obligations, under present commitments or agreements (Maritime Act, section 309). Under the financing charter provisions enacted in the Marshall Islands in March 2013, the Marshall Islands became the first registry to permit the registered owner in a financing charter to record the bareboat charter as a species of preferred mortgage. These new provisions, as further refined by the Maritime (Amendment) Act 2016, allow the registered owner, typically a financial institution or affiliate, to hold title and be deemed a preferred mortgagee up to 'the aggregate maximum amount of the nominal amount of all charter hire payments, termination payments and purchase or put option amounts payable, or which may become payable, under the charter as well as any interest, indemnities, expenses or fees' (Maritime Act, section 302A). The new law permits financing structures similar to those used for aircraft and railcar net lease financing. To date, 68 financing charters have been registered as preferred mortgages in the Marshall Islands under the new law.

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

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

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

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

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

Section 302 of the Maritime Act requires that a mortgage state 'the amount or amounts of the direct or contingent obligations [...] that are or may become secured by the mortgage'. In the case of revolver facilities or committed facilities not fully drawn at closing, the mortgage may either be stated as the maximum amount that may be drawn at any time or as the 'aggregate of all possible advances' (Maritime Act, section 309). There is no stated requirement to attach and file a copy of the agreement creating the obligation secured. However, as a matter of practice, parties do normally attach the form of or a copy of the executed note, credit facility, guaranty or other evidence of the secured obligation.

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

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

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

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

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

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

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

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

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

In addition, any maritime lien claim for necessities that arose prior to the registration of the preferred mortgage would also have priority over the preferred mortgage (Maritime Act, section 303(1)).

Section 319(1) of the Maritime Act states that:

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

These necessities liens will rank in a subordinate position to any preferred mortgage registered against the vessel before such liens arose.

22 What maritime liens rank higher than a mortgage lien?

A preferred maritime lien ranks higher than a preferred mortgage under the Maritime Act. These preferred maritime liens are those six categories set out in question 21 as well as any other maritime liens that

arise prior to registration of the preferred mortgage. As between mortgages, the rule is 'first in time, first in right,' subject to any consensual subordination or intercreditor arrangement between mortgagees.

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

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

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

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

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

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

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

The Maritime Act is silent on whether a mortgagee may sell a vessel privately in the Marshall Islands and what effect that would have on claims against the vessel. Section 318 of the Maritime Act provides that a sale of a vessel in an in rem suit in the Marshall Islands High Court would terminate all pre-existing claims in the vessel. The proceeds would be applied in payment of claims of creditors as indicated in question 21.

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

Generally speaking, a vessel will be 'free and clear' of all liens or claims whatsoever following an arrest and foreclosure sale in a public auction overseas. In the US it is possible, but highly unusual, for a mortgagee to arrange the sale of a vessel privately after arrest subject to confirmation by a federal court. It is unclear at best whether such sales, even if valid in the US, would be given wide recognition in other countries.

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

Most nations insist on the sale of arrested vessels by or through specialised courts, admiralty or otherwise, as a predicate to the discharge of all liens and encumbrances. Resort to self-help remedies as an aid in advance of foreclosure has long been in use in many countries in the enforcement of ship mortgages, including Marshall Islands preferred mortgages.

Update and trends

In recent years, the Marshall Islands has striven to conform its statutory and regulatory requirements applicable to business entities to comply with tightening international, regional and national measures designed to counter tax avoidance, money laundering and terrorism.

In the past year, the Marshall Islands has enacted new provisions requiring enhanced record keeping and reporting as to shareholders, beneficial ownership of equity interests and transfer of interests. This particularly affects corporations issuing bearer shares, which are still allowed under Marshall Islands law. As it is, many, if not most institutions already refuse to finance enterprises issuing or even permitting the issuance of bearer shares, as the reliability of Know Your Customer (KYC) disclosures is inherently suspect in those cases.

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

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

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

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

Collateral

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

Since early 2013, Marshall Islands law has permitted the recordation of financing charters and elevated their status to a species of preferred mortgage. Section 302A provides that a bareboat or demise charter can be registered for recordation by either the documented owner or the charterer. In order for the charter to be registered, the charter must be signed and acknowledged by both parties; include the name and official number of the vessel, the date, the name and addresses of both parties; and state the total 'nominal amount of all charter hire payments and purchase option amounts payable, or which may become payable thereunder, exclusive of any interest, indemnities, expenses, or fees'.

It should be noted that merely registering or recording a document as a financing charter does not make it so. A court asked to enforce a registered financing charter could determine based on the evidence that the agreement is not a financing charter or does not create a security interest in favour of the documented owner under applicable law.

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

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

As noted in question 29, a court could determine that a charter registered as a 'financing lease' is not in fact a financing lease because of its economic characteristics and thereupon recharacterise the charter as a true lease, operating agreement or otherwise, leaving the documented owner to be characterised as the true owner and not a secured party. If the documented owner is found to be a true owner, its claim

to the vessel would fall behind all creditors. In any case where this result would seem to be a significant risk, the parties should structure the deal at the outset to include back leverage secured by conventional preferred mortgages.

However, the concerns that drove the creation of section 302A came from the opposite direction, the fears of a title-holder that his or her charter would be recharacterised as an unperfected security interest.

The first financing charter transaction making use of section 302A was closed only in March 2014.

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

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

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

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

33 How is a security interest over a deposit account established? How is a security interest perfected?

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

34 How are security interests in non-vessel collateral enforced?

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

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

Pledges of shares or other ownership interests are established by the grant normally included in a pledge agreement. As noted above, the

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

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

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

Tax considerations for vessel owners

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

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

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

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

There is a tonnage tax on vessels registered in the Marshall Islands. However, this is not paid to gain an exemption from income tax, which generally does not apply to non-resident domestic or foreign companies. See question 37.

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

Income earned by non-resident entities (either domestic or foreign) from operation of Marshall Islands-flagged vessels registered under the Maritime Act is exempt from Marshall Islands taxation (BCA, section 12).

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

Not applicable in the Marshall Islands.

Insolvency and restructuring

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

No, the Marshall Islands has no such procedure. We understand that it has an internal procedure in the nature of an assignment for the benefit of creditors but that it is not adequate to work through a shipping insolvency where worldwide jurisdiction over the debtor's assets is critical to success.

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

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

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

We have no information indicating that the Marshall Islands has adopted this Model Law.

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

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

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

A Marshall Islands vessel owner may guarantee the obligations of another entity or provide a security interest in the vessel owner's property, including a mortgage over the owner's vessels, to secure the obligations of another if it is in the business interest of the vessel owner or, in any case, if the shareholders of the vessel owner approve the guaranty or grant of security interest (see question 6). A lender or other guaranteed party should take care that any such guaranty or grant of security is both grounded in the guarantor's business interest and also approved by shareholders. The guaranty or grant should recite with some particularity what the business interest is and the reliance of the guaranteed party or secured party on the guaranty or security grant.

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

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

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

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

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

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

We have no information to indicate that the Marshall Islands has adopted any version of the Model Netting Act of ISDA.

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