

NAVIGATING ATTENDANT RISK IN SHIP FINANCE TRANSACTIONS

By Ayuli Jemide (being an abridged word version of presentation at a recent Detail Solicitors Knowledge Management Seminar)

The risks that attend Ship Finance transactions are peculiar for several reasons, these include the fact that: ships are mobile assets; shipping has strange concepts and shipping knowledge is quite scarce. However every risk can be a calculated risk if the information is well researched to enable an “informed decision” – weighing the pain against the gain. In calculating the risk the financier should look at: The mode of acquisition to be assured that it is tidy, then the operations – to be assured of cash flow and remittances, and finally the ease of enforcement in the event that the need arises. What information would you require to calculate your risk? Like every transaction we must start from the basic (foundational) information and work our way forward accordingly. One basic question is whether the ship is a used one or it is being built to order. One would probe further in the proper direction, depending on whether it is a new build to order or used vessel purchase.

NEW BUILD: WHAT FURTHER QUESTIONS?

1. Does the buyer have any shipping knowledge?
2. Do the terms of the ship building contract protect you?
3. What is the reputation of the builder? Are ships from the yard known to be well built? Do they deliver on schedule?
4. What is the intended use of the ship? Do the drawings and specifications match that purpose?
5. Are there specific concerns given the terrain in which the ship would function?
6. Is the vessel sailing to Nigeria or arriving as knock down parts?

NEW BUILD: WHAT ARE THE ATTENDANT RISKS?

1. What is the security for funds advanced to the shipbuilder?
2. How do I establish Privity of Contract with the builder?
3. What is the assurance on delivery time and specifications?
4. What remedies avail in the event of builder’s breach?
5. How will the ship arrive? Are we covered for journey risks?

Let us consider question as to whether we can obtain security for advances to shipbuilder. In doing so the keys issues are: (1) Does a buyer have title to an incomplete ship? (2) Can a ship under construction be mortgaged? Legally there is no provision for registration of a legal mortgage on a Ship under construction. (Re Softly, exparte Hodgkin (1875) L.R. 20 Eq 746). There a however a solution for the financier in financing a ship building. The solution is for the borrower/buyer to procure title because with title the buyer can pass an equitable or common law mortgage NOT a legal mortgage. How does the buyer procure title? The buyer should specify in the ship building contract that title to ship passes to the buyer during construction NOT AFTER It is worthy of note that typical Asian ship building contracts would state that title passes during construction, but the typical European ship building contracts would state that title passes on delivery. With title in the kitty

the Buyer then assigns the ship building contract with all rights and interests to the financier with a memo of deposit of the original contract. – This constitutes an equitable mortgage. *Union Bank of London v Lenanton* (1878) 3 C.P.D 243 (C.A)

NOTE: Ensure that the assignment includes all components and materials purchased by the ship builder for the construction (whether on the yard or not) and that the building contract incorporates this. Otherwise they are excluded.

USED VESSEL: WHAT FURTHER QUESTIONS?

With a used vessel there are three ports of call for further enquiries:

A. THE REGISTER OF SHIPS

1. Where is the ship registered?
2. What is the registered ownership and ownership structure?
3. Are there any pending mortgages?
4. What is the procedure for sale, mortgage and deletion at that registry?
5. Are there any outstanding issues: inspections, fees unpaid etc.?

B. THE SHIP:

1. What is the value of the ship?
 - Actual or
 - forced sale or
 - depreciated at likely time of enforcement.
2. Is it fit for the purpose intended by the buyer?
3. Is it classed by a recognized classification bureau?
4. How old is the ship? What is the condition?
5. Any Liens? - Possessory, Maritime, or Statutory Note that some of these liens follow the ship and not the owner, so a change of ownership does not erase the lien.
6. Maintenance history with proof thereof
7. Latest inspection certificates

It is advisable to get an independent consultant surveyor to review the status of the ship.

C. THE SELLER/BUYER

1. Is there a clear nexus between the seller and the ship?
2. Are there other shareholders of the 64 shares in the ship?
3. What is the status of a company ship owner at Corporate Affairs Commission?

Note: that a charge on the company fixed and floating assets may in certain situations cover the ship and/or the expected earnings. Note: that Register of Ships is prima facie but not conclusive proof of the ownership of a vessel. – *Baumwoll Manf Von Carl Scheibler v Furness* – 1893 AC 8 H.L

Let me highlight the issue of valuation of the ship raised in B1 above. Many financiers never bother to find out what the value of the vessel is vis-à-vis the loan. This valuation should be mindful of depreciation at the likely time of enforcement. Some would rather go with a forced sale value in the sense that a vessel sold under enforcement can never attract the same value as one purchased in normalcy, except where the borrower and seller are in concert in the sale.

OTHER LEARNING POINTS

1. A registered Mortgage protects the ship from any bankruptcy proceedings of the borrower. S325 MSA
2. The first in time for registration takes precedence over subsequent mortgages. In syndicated lending all the lenders can be joint mortgagees and their relationship inter se regulated by an inter lenders agreement
3. Until a Bill of Sale is registered it passes only beneficial ownership and not title. Seller therefore retains power to resell prior to registration – The Horlock - (1877) 2 P.D 243
4. Where there is more than one mortgagee, a subsequent mortgagee shall not (except by order of court) sell the ship or a share without the concurrence of every prior mortgagee - S 326 (2) Merchant Shipping Act.
5. A separate Assignment of all the earnings of the ship allows the lender to pursue and collect earnings not domiciled by the borrower. Do not forget to give notice of the assignment to the charterers.
6. Shipping documents are Stamp duty exempt – Schedule 1, Stamp duties Act
7. In some situations it may be advisable to set up a new company solely to own the ship – one ship holding company. The advantages are:
 - A. Financial risk on the ship is isolated
 - B. Lender may take a pledge on the shares of the company which allows easy sale of the company on default.

The success of ship financing and acquisition like every other type of sale/purchase is dependent of requisite information that enables the party preview (rather than review) the attendant risks.

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