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Item 2 of the provisional agenda

FINAL READING OF THE DRAFT ARTICLES FOR
A CONVENTION ON MARITIME LIENS AND MORTGAGES

Note by the UNCTAD secretariat

The attached text */ has been submitted by the United States of America for consideration by the Joint Intergovernmental Group of Experts at its sixth session.

*/ Also circulated under the symbol LEG/MLM/23.

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ON MARITIME LIENS AND MORTGAGES

Submission by the United States of America

Introduction

The observations and proposals set forth below are submitted for consideration by the IMO/UNCTAD Joint Intergovernmental Group of Experts (JIGE) on Maritime Liens and Mortgages and Related Subjects at its sixth and final session.

The articles cited herein refer to the Revised Draft Articles for a Convention on Maritime Liens and Mortgages published in Document JIGE (VI)/2 (circulated as IMO Document LEG/MLM/21 and as UNCTAD Document TD/B/C.4/AC.8/21). All proposals for amendment of the Revised Draft Articles indicate suggested new text with underlines and suggested deletions with obliques.

Article 3

There is broad agreement that this article is critical to the development of an effective system for protecting vessel mortgagees in cases involving voluntary changes from the registry of one State Party to that of another. In our view, greater clarity would be achieved if paragraph 1 of this article focused solely on the responsibilities of the State conducting a deregistration, while paragraph 2 addressed only the responsibilities of the State conducting a reregistration. Moreover, much of the present confusion concerning theoretical gaps and overlaps in registration could be eliminated if the article 3.2 requirement was simplified so that States Parties undertook an obligation not to reregister a previously registered vessel unless the previous State of registration certified that all deregistration requirements had been met.

With the foregoing observations in mind, we would propose the following amended text for article 3:

Article 3

Change of ownership or registration between States Parties

1 In the event that a voluntary change of ownership [or change of registration] entails the deregistration of the vessel from the national register of a State Party, such State Party shall not permit the owner to deregister the vessel unless all mortgages, "hypotheques" or charges are previously satisfied ~~deregistered~~ or the written consent of all holders of such mortgages, "hypotheques" or charges is obtained.

2 With the exception of forced sales, [with no prejudice to] a vessel which is or has been registered in a State Party shall not be eligible for reregistration in another State Party unless the former State Party certifies that the deregistration requirements of this article have been complied with. ~~with.~~

- (a) ~~a certificate has been issued by the former State Party of the effect that a vessel has been deregistered.~~
- (b) ~~a certificate has been issued by the former State Party of the effect that the vessel will be deregistered with immediate effect at such time as the new registration is effected. The date of registration shall be the date of deregistration of the vessel by the former State.~~

Article 4

In conducting its final review of the article 4 list of preferred maritime liens, the Joint Group may wish to consider two changes to the present list: specifically, the reintroduction of general average (to be ranked with salvage) and the elimination from article 4.1(e) of the restriction of tort claims to those "other than loss of or damage to cargo, containers and passengers' effects carried on the vessel." Retention of maritime lien status for general average claims appears more consistent with established international law and practice, and might conceivably broaden the appeal of the new Convention for certain States; affording cargo, container and passenger interests the opportunity to avail themselves of the maritime lien remedy where vessel owners have been responsible for damage is, in our view, both equitable and desirable.

If the foregoing amendments were adopted, revised article 4.1 would read as follows:

Article 4

Maritime liens

1 Each of the following claims against the owner, demise charterer, manager or operator of the vessel shall be secured by a maritime lien on the vessel:

- (a) claims for wages and other sums due to the master, officers and other members of the vessel's complement in respect of their employment on the vessel, including costs of repatriation and social insurance contribution payable on their behalf;
- (b) claims in respect of loss of life or personal injury occurring, whether on land or on water, in direct connection with the operation of the vessel;
- (c) claims for salvage and general average;
- (d) claims for port, canal, and other waterway dues and pilotage dues;
- (e) claims based on tort arising out of physical loss or damage caused by the operation of the vessel/~~ØKKEZ/~~
~~KKK/loss/ØZ/ØZ/damage/ØØ/ØØØØ/ØØØØØØØØ/ØØØ/~~
~~passengers/ØØØØØ/ØØØØØ/ØØ/ØØØ/ØØØØØ.~~

One further observation: with respect to article 4.2, the meaning of the phrase "within the scope of" in reference to the 1969 International Convention on Civil Liability for Oil Pollution Damage (1969) remains unclear. If the phrase is intended to preclude a maritime lien from arising in cases where there is an actual remedy provided through the 1969 Convention, this result would be appropriate in that duplicate remedies would be avoided. If, however, the intention is to preclude maritime liens in all cases involving what is generally contemplated by, or for which compensation could theoretically be available through, the 1969 Convention, this much different result would discriminate against potential claimants in States not party to the 1969 Convention. In our view, the latter interpretation would be inequitable and would constitute an undesirable precedent. If the Joint Group determines that this matter should be clarified, we would suggest that consideration be given to substituting a phrase such as, "for which compensation is payable to the claimants pursuant to" in place of the current formulation in article 4.2 (i.e., "within the scope of application of").

Article 6

The draft instrument under development should, in our view, afford ample protection for all maritime claimants who extend credit in respect of a vessel. In light of the Joint Group's previous decision not to provide an article 4 preferred maritime lien for ship suppliers, we propose that renewed consideration be given to creation of an express non-preferred maritime lien for marine suppliers as well as provision of an option permitting States Parties to create other national maritime liens. Such maritime liens would provide an effective basis for the worldwide enforcement of legitimate claims without jeopardizing the security interests of preferred maritime lien holders or vessel mortgagees whose claims would receive priority. Without the greater assurance of payment provided by the option of maritime lien enforcement, worldwide vessel operations may become more difficult if suppliers are no longer willing to extend credit to vessel owners/operators.

To accomplish the foregoing, we propose the following substitute text for the existing article 6:

Article 6

Other maritime liens

1 Claims for the supply of goods, materials, provisions, equipment, appurtenances or services in furtherance of the operation, navigation, repair or maintenance of the vessel shall be secured by a maritime lien. Such maritime liens shall rank after the maritime liens set out in article 4 and the mortgages, hypothèques and other charges which comply with the requirements of article 1, and shall rank inter se in the inverse order of the time when the claim secured thereby accrued.

2 Each State Party may grant additional maritime or other liens to secure claims other than those referred to in article 4 and paragraph 1 of this article. Such liens shall rank after the maritime liens set out in article 4, the registered mortgages, "hypothèques" or charges which comply with the provisions of article 1 and the supply liens set out in paragraph 1.

Article 6 bis

The precise intention of this proposed article and the nature of the relationship between rights of retention and both maritime liens and mortgages, hypothèques and other charges appears unclear and, in our view, might lead to considerable

confusion in practice. To illustrate, what is the meaning of the current provision in article 6 bis.2 to the effect that rights of retention "shall not prejudice the enforcement of the maritime liens set out in article 4, but may be exercisable against the vessel, notwithstanding the existence of any registered mortgages, "hypothèques" or charges"? How would such "enforcement" work in practice? And is this language intended to imply that article 4 maritime liens enjoy a unique priority, whereas mortgages and similar charges do not? It is essential that this provision be clarified in order to eliminate any ambiguity which might prove detrimental to the security interests of vessel mortgagees.

Moreover, there is no definitive rule addressing the question of how rights of retention fit into the priority scheme for the distribution of proceeds in the event of a forced sale. For example, article 11.2 currently has bracketed text to the effect that the "balance of the proceeds shall be distributed among the holders of maritime liens and rights of retention..." However, there is no specification in this article or elsewhere as to what distribution priority is to be assigned to holders of rights of retention.

The present confusion surrounding rights of retention is understandable in view of the complexities associated with incorporating and integrating unique enforcement mechanisms from contrasting legal systems in one treaty instrument. We simply wish to draw the attention of the Joint Group to the existing ambiguities and inconsistencies, and to urge that the intended relationship between rights of retention and maritime liens and mortgages be examined further to ensure that sufficient guidance is provided to implementing States.

Article 8

A one-year expiration period would, in our view, not afford maritime lien claimants a reasonable opportunity to enforce their claims in certain cases. In light of the deliberations on this matter which took place at the Joint Group's fifth session, we propose that article 8 be amended to allow for a maximum two-year expiration period where the claimant notifies the registrar in the State of registration of the claim within the original one-year period.

The following amended text is therefore proposed for article 8:

- (c) all holders of registered mortgages, "hypothèques" or charges issued to bearer and all holders of the maritime liens set out in article 4, provided that the competent authority conducting the forced sale receives notice of their respective claims.

2 Such notice shall be provided at least 30 days prior to the forced sale and shall contain either:

- (a) the time and place of the forced sale; or
- (b) such particulars concerning the forced sale or the proceeding leading to the forced sale as the State conducting the proceeding shall determine is sufficient to protect the interests of persons entitled to notice.

3 In addition to any notice by publication, such notice shall be written, and may be given by receipted post or by electronic or other appropriate means which provide confirmation of receipt.

4 If permitted by the national law of the State conducting the proceeding, any person entitled to receive notice in accordance with this article may waive such notice.

Article 11

The inclusion of the requirement in article 11.1(c) that forced sale proceeds be "actually available and freely transferrable" has broad ramifications and may lead to serious difficulties in practice. While this proposed language was intended to protect the interests of vessel mortgagees and other creditors, the actual result may be exactly the opposite.

In the first instance, this requirement may effectively eliminate the common practice of credit bidding. This practice enables mortgagees to protect their investment by using the mortgage indebtedness to purchase the vessel and undertaking to pay all expenses and other claims which are determined to rank above the mortgage. While often the most advantageous strategy for vessel mortgagees seeking to protect their interests, and generally the best outcome possible for the other secured creditors, this practice typically does not involve the deposit of "proceeds" as contemplated by the article 11.1(c) rule.

Even more importantly, implementation of this rule would probably depress forced sale prices in certain cases. Potential bidders might be deterred from depositing a large purchase sum in a distant jurisdiction owing to the unattractive prospect of not being able to either reclaim the money deposited (owing to currency restrictions) or obtain clear title to the vessel (owing again to the currency restrictions which might preclude satisfying the claims of vessel creditors). This circumstance would clearly favor local bidders, thereby contributing to a situation in which all vessel creditors might suffer in that the forced sale would command a much lower price.

Another concern is the present ambiguity as to when the proceeds must be "actually available and freely transferrable." Is this requirement satisfied once and for all if met on the day of the forced sale, or could the subsequent imposition of new currency controls effectively cloud the title of a vessel because certain of its former creditors have not yet been paid? This concern is quite significant in that in practice several months or more may be required to sort through all of the various claims and effect the final distribution of proceeds.

In our view, the requirement in question, while a worthwhile proposal in concept, would be fraught with difficulties in practice, and should therefore be deleted in both article 11.1(c) and 11.3. We would, however, consider an alternative means of achieving the underlying objective of expediting the distribution of forced sale proceeds if this can be accomplished without jeopardizing the security interests of vessel mortgagees and other creditors.

One further point. In order to preclude the possibility that recognition of forced sales - and hence the validity of vessel titles and subsequent mortgages - might be subject to challenge based on any failure to comply even with technical provisions of the Convention, we would suggest that the only appropriate focus in article 11.1(b) is the forced sale requirements. The scope of the current provision (which includes the phrase "and all of the provisions of this Convention have been observed") is too broad and should be curtailed.

Accordingly, we would propose that article 11 be amended as set forth below; the existing alternative provisions in square brackets in article 11.2 have been retained in light of the present uncertainty concerning the status and significance of rights of retention:

Article 11

Effects of forced sale

1 In the event of the forced sale of the vessel in a State Party all mortgages, "hypothèques" or charges, except those assumed by the purchaser with the consent of the holders and all liens and other encumbrances of whatsoever nature, shall cease to attach to the vessel, provided however that:

- (a) at the time of the sale, the vessel is in the area of the jurisdiction of such State, and
- (b) the sale has been effected in accordance with the law of the said State and ~~all of~~ the provisions of this Convention ~~have been observed, and~~
- (c) ~~the proceeds of the sale are actually available and freely transferable.~~

2 The costs and expenses arising out of the arrest or seizure and subsequent sale of the vessel including the costs incurred for the upkeep of the vessel from the time of arrest and the costs of repatriation of the crew, and of the distribution of the proceeds shall be paid first out of the proceeds of sale. [The balance of the proceeds shall be distributed among the holders of maritime liens and rights of retention mentioned in articles 4 and 6bis and registered mortgages, "hypothèques" or charges, in accordance with the provisions of this Convention to the extent necessary to satisfy their claims.] [The balance of the proceeds shall be distributed in accordance with the provisions of this Convention.]

3 When a vessel registered in a State Party has been the object of a forced sale in a State Party, the competent authority shall, at the request of the purchaser, issue a certificate to the effect that the vessel is sold free of all mortgages, "hypothèques" or charges, except those assumed by the purchaser, and of all liens and other encumbrances provided that the requirements set out in paragraphs 1(a) and (b) have been complied with ~~and that the proceeds of such forced sale have been deposited with the authority that is competent under the law of the place of sale and that these proceeds are actually available and freely transferable.~~ Upon production of such certificates, the registrar in a State Party shall be bound to delete all registered mortgages, "hypothèques" or charges except those assumed by the purchaser, and to register the vessel in the name of the purchaser or to issue a certificate of deregistration for the purpose of reregistration, as the case may be.

Article 15

As currently drafted, article 15(c) is a significant concern in that it effectively creates another condition on the validity of mortgages (i.e., the actual entry in each case of the appropriate cross-references in the registers of two States). As a matter of principle, it would not seem advisable to condition mortgage validity on the fulfillment of an administrative requirement of this nature; moreover, vessel mortgagees are simply not in a position to verify compliance with this condition throughout the duration of the mortgage.

The concept underlying such cross-references, however, is fundamentally sound and highly desirable. We would thus suggest that the requirement simply be changed so that States Parties undertake an obligation to require such cross-references in their systems of registration, thereby avoiding the potential peril for vessel mortgagees.

Accordingly, we would propose the following substitute text for article 15(c) and the clarification indicated for the chapeau:

Article 15

Temporary change of flag

If a seagoing vessel registered in one State Party is permitted to fly temporarily the flag of another State Party, the following shall apply:

- (c) The State of registration shall require a cross-reference entry in its register specifying the State whose flag the vessel is permitted to fly temporarily; likewise, the State whose flag the vessel is permitted to fly temporarily shall require a cross-reference entry in its flag register specifying the State of registration.

Conclusion

In our view, the Joint Group has yet to take a number of important decisions concerning the Draft Convention on Maritime Liens and Mortgages which may have significant impacts for both vessel mortgagees and maritime lienholders. Owing to the many complex interrelationships among the various articles, after all of the fundamental decisions are taken, the United States may suggest further consequential changes to the final text at the upcoming sixth and final session.

In addition to completion of the Draft Convention on Maritime Liens and Mortgages, the provisional agenda for the final session of the Joint Group includes consideration of possible revision of the International Convention Relating to the Arrest of Seagoing Ships (1952). In that both the time available for and the precise scope of such consideration are presently uncertain, the United States reserves the right to introduce specific proposals in respect of this subject prior to or during the final session of the Joint Group.
