

## Chapter 1

# Introduction

Updated by Lucy French

*The method of obtaining finance for ships... may be summarised in these words. The bank advances to one or more owning companies a large sum of money. It of course requires security. It will take a mortgage on the ship for that security. It may take other mortgages on other ships for the same security. If the ship, as often happens, is about to be time chartered, then the bank will take an assignment of the time charter in order that the bank as assignee can benefit from the time charter in order to reduce the mortgage debt. In addition it will... take an assignment of insurance policies and P and I Club cover in order that in the event of total or partial loss of the ship the bank as the lender may be suitably secured... The effect of this is to ensure that the lending bank is completely secured against the insolvency of the borrower who intends that the bank shall obtain complete priority over the claims of other creditors against the borrower.<sup>1</sup>*

In general terms then, that is what ship finance and hence this book is all about. The bottom line of any ship finance deal is that a bank or some other lender advances money to a shipowner to assist the owner to build a new ship; buy a second-hand ship; convert, repair or alter a ship; or refinance existing indebtedness secured on a ship. The lender must be secured and looks, for his principal (though by no means only) security, to the ship itself.

Of course, there are many permutations, many refinements, many factors to be taken into account, and the aim of this book is to explore some of them. It is not intended to be a fully comprehensive textbook on shipping or banking. Rather, it is intended to highlight the particular factors that make ship finance different from other types of lending. One general topic not covered in this third edition is tax – not because it is no longer relevant, far from it. A discussion on the tax aspects of shipping finance, to be of any real value, would require an entire book. A single chapter would not do justice to such a huge subject.

Ship finance is no more a fixed science than is any other sort of finance. Financial terms and conditions change – especially in a cyclical industry such as shipping – and banks and owners become ever more sophisticated. Different types of vessel require lenders to take into account different considerations. Ultimately, though, the starting point is the same. The bank lends and the borrower secures the repayment of the loan by mortgaging his ship to the bank. Invariably there will be other security. What and why will be explored later.

### **The international element**

More than most other forms of finance, ship finance is international. A ship is an unusual asset. Most ships move – or are capable of moving – all over the world. The financing of large ocean-going ships is undertaken by banks all over the world, by no means just for owners in

their own country. On the contrary, and certainly for larger ships and larger owners, one is more likely to find, for example, an American bank, acting through its London office, lending to a Greek-controlled owning company and securing itself on a Liberian registered ship. There may be a degree of patriotism – but if a foreign bank can offer better terms, then owners, accustomed to international dealings in the everyday operation of their ships, will not be troubled about dealing with foreign lenders.

There are two common elements. First, the universal currency of international shipping is the US dollar. Loans in other currencies, except to owners who operate their vessels within narrow geographical confines, such as ferry operators, and therefore have the bulk of their income in local currency, are relatively rare. For ships that trade worldwide, income will almost invariably be in US dollars and ships will be bought and sold in US dollars; hence, to limit exposure to currency fluctuations, loans (and loan repayments) will be in US dollars. (Although multi-currency options appear in facilities from time to time, they tend normally to be dollar based.)<sup>2</sup>

The second common element is the importance of English law. London remains one of the world's major shipping centres. Although major British owners are now few and far between, and the importance of the Baltic Exchange for fixing employment for ships has diminished as technology has advanced, a very large proportion of the world's fleet is insured or reinsured through the London insurance market and much financing is still done by banks in London. English law, and London arbitration, are common choices of parties to shipping contracts, such as charterparties, even where those parties have no obvious connection with England and where the ship may never come near an English port. This is not to play down the role of other legal systems: it is simply that historically English law has attained an ascendancy in the world of shipping which other legal systems have yet to succeed in shaking off.

### Ship registration

Assets, generally speaking, fall into three categories. There are immovables (principally land); tangible movables (for example, ships, cars or furniture); and intangibles (for example, bank balances and trade creditors). Commonly, immovables are subject to some form of registration system – for example, in England title to most land is registered at HM Land Registry – but movables are not. Ships, however, are an exception to this general rule.

There are several reasons for this. First, ships travel the world. For a large part of their life they are on the high seas, outside the jurisdiction of any particular country. Secondly, they are more valuable assets than many other tangible movables and lenders will normally want to take security over them (which is difficult to do in many legal systems on an unregistered asset without physical possession). Thirdly, they are strategic assets, of great value in time of war. Fourthly, for economic and political reasons countries may wish to restrict certain types of trade to their own flag ships.

Not surprisingly, with a view to controlling the numerous national systems of registration and preventing a complete free for all, international law has intervened, chiefly by a series of United Nations (UN) conventions, mostly in the 1980s, including the 1982 UN Convention on the Law of the Sea (the 1982 Convention). Now signed by approximately 150 countries, the 1982 Convention only came into force on 16 November 1994, one year after it had been ratified by the required minimum of 60 countries.

Article 90 of the 1982 Convention provides that every state has the right to have a merchant fleet under its flag, and vessels in that fleet are entitled to the use of the high seas. Article 91 provides that ‘every state shall fix the conditions for the grant of 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 be a genuine link between the state and the ship.’

The 1982 Convention stops there and does not tell us what constitutes a ‘genuine link’. The 1986 UN Convention on Conditions for Registration of Ships tries to help by describing the requirement of a genuine link as meaning that nationals of the flag state must participate in the ownership, manning or management of the vessel. This Convention has not yet been signed by a sufficient number of countries to come into force and it is unlikely that it will. Certainly, it has not been signed by many important ship registry jurisdictions.

As anyone with any involvement with the shipping industry will know, this is not how ship registration works in practice.

### **The different types of registry**

Traditionally, a ship owned by a national of a particular country was registered in that country and crewed by nationals of that country. It was subject to the jurisdiction of the authorities of that country, and was liable to requisition by those authorities in time of war. In many countries, the owner had no say in the matter and registration was obligatory. In the United Kingdom, registration of British ships was compulsory from the Navigation Acts of 1660 onwards. Section 2 of the Merchant Shipping Act 1894, which codified the previous law and held sway for over 90 years, made it mandatory for a British ship (subject to certain minor exemptions) to be registered in accordance with the Act. Although not specifically defined in the Act, the term ‘British ship’ meant, in summary, any ship owned by a British subject or a body corporate established under the laws of some part of Her Majesty’s dominions, with a principal place of business in those dominions.

Only in 1989, with the coming into force of the Merchant Shipping Act 1988, did the rules change so that a British ship was entitled to be registered, and was the only type of ship entitled to be registered, in the United Kingdom, but was no longer under any obligation to be registered. Now, under the Merchant Shipping Act 1995, the test is that a majority of the shares in the ship must be owned by someone with ‘a British connection’.<sup>3</sup>

Since the middle of the twentieth century there has been a marked change in the operation of ship registries and the expression ‘flag of convenience’ is now well known. The historical background is that, before and after the Second World War, several countries began to open up their ship registers to all comers. Beginning with the use of the Panamanian flag by US cruise ship operators during the prohibition years, the trail blazers were the so-called PanLibHon registers – Panama, Liberia and Honduras. Although Honduras has declined dramatically in importance (it is now only just inside the top 50 registries in terms of gross tonnage), Panama and Liberia have had sufficient success to make them, by gross registered tonnage, the world’s two largest fleets. More recently, other countries have joined the club, including Cyprus, the Bahamas and the Marshall Islands.

The chief distinguishing characteristic of these open registers is their lack of restriction. As will be seen in more detail later, anyone can, broadly speaking, register his ship on one of

these registers, as long as the ship satisfies the register's requirements as to, for example, age and technical standards. Sometimes, as in Cyprus, it is necessary to set up a locally registered company to own the ship, but normally a shelf company can be acquired in a matter of hours and usually there are no restrictions on the nationality or identity of the directors or shareholders. Chapter 11 deals in more detail with vessel registration and the ownership requirements for various flags.

As well as being unrestricted as to ownership, the open registers for the most part impose no restrictions on the nationality of the officers and crew employed on vessels registered on them, though officers must normally satisfy certain technical standards. Again, this compares with the traditional national registers, where strict requirements for officers and crews, either as to nationality or as to pay rates, are frequently imposed. This has a dramatic impact on the running costs of a vessel, for the obvious reason that crews from less developed countries come much cheaper than those from developed nations. Some national registers have fought back, with the introduction by their governments of tonnage tax schemes. In addition to providing strong tax incentives for owners to enter the scheme and thereby boost that country's maritime industry, many tonnage tax schemes have made a commitment by the prospective tonnage tax company to seafarer training a compulsory requirement for acceptance of that company on the scheme. Such a requirement helps to expand the pool of qualified officers in that country.

Nevertheless, crews from developing countries have become, to a large extent, the norm. Many owners will say, not without some justification, that without the latitude to employ cheap crew they would have been forced out of business long ago. Their arguments have not found much favour with the International Transport Workers' Federation (ITF) which has waged a long and vigorous campaign to protect these seamen from exploitation. One result of the campaign has been the designation by the ITF of certain registers – principally the open registers – with the supposedly pejorative term 'flag of convenience'. Any ship registered under a flag of convenience is liable to be subject to action such as blacking by members of ITF-affiliated unions unless it can produce a certificate that it has satisfied the ITF that its crew's conditions of employment meet certain minimum standards.

The ITF has another concern, which brings us to another criticism often made of the open registers. The ITF is not just concerned with the financial well-being of seafarers, but also their physical well-being, and continues to campaign against what it sees as unacceptably low safety standards on ships. The safety standards applicable on board ships are ultimately a matter for the flag state, which may or may not adhere to certain internationally accepted standards. Safety concerns and a desire to raise standards worldwide, resulted in the International Maritime Organisation (the United Nations' agency responsible for improving, among other things, maritime safety) introducing the International Safety Management Code (ISM Code) in the mid-1990s.<sup>4</sup> The ISM Code has made it compulsory since 1 July 1998 for ships and their owners and managers to have adequate safety management systems in place, both on board and ashore. Governments are responsible for carrying out ISM audits and for issuing certificates showing that the ISM Code has been complied with by a ship and its owners and managers. Ships without valid ISM Code certification are prevented from trading. Owners (and their lenders) will therefore avoid registries who fail to monitor these international standards to an acceptable level and have neither the resources nor the technical expertise under their control to meet their obligations under the ISM Code.

Similarly, following the terrorist attacks of 11 September 2001, governments recognised the need to put in place a worldwide set of security rules for both ships and ports, to make the shipping industry less vulnerable to terrorist attack. The International Ship and Port Facility Security Code (ISPS Code) came into force on 1 July 2004<sup>5</sup> and, with a very few exceptions, applies to all passenger and cargo ships and to all port facilities servicing such ships, engaged in international voyages. Ship registries are responsible for setting the security levels and requirements for ships entitled to fly their flag and for monitoring compliance. A ship without valid ISPS Code documentation will not be able to trade and, as with the ISM Code, open registries who are unable to carry out their ISPS Code obligations will find that no matter how attractive a choice they may otherwise be, they will not be acceptable to either owners or lenders.

As well as the traditional open registers, such as Liberia and Panama, two other types of register have developed. The offshore register is typically a register established in a colony or dependency of a particular country, with a view to attracting the registration of ships from that country which might otherwise go to an open register. The United Kingdom led the way, with offshore registers in places as diverse as Bermuda, Gibraltar, the Isle of Man and the Cayman Islands and Dutch shipping has taken advantage of the Netherlands Antilles.

In many cases, these dependencies are well established as centres for offshore finance and the use of their ship registers has followed almost accidentally. Their general approach is to allow owners to fly the flag of the home country (such as the Red Ensign), while imposing less strict requirements for ownership and crewing than the home register. There may also be tax advantages in operating in a tax haven jurisdiction with low, or no, corporation tax and, very possibly, no obligation to deduct income tax or national insurance at source from officers' and crews' wages. Many of the offshore registers are also classified as flags of convenience by the ITF, either completely or on a vessel-by-vessel basis depending on the nationality of the vessel's ultimate owner.

The other type of register is the international register. This is much the same as the offshore register but does not rely for its existence on the accident of a convenient dependency and is set up in the home country and run parallel to the domestic register. Much the most successful example of this species is the Norwegian International Ship Register (NIS), set up in 1987. Other countries with international registers are Denmark, Turkey and Italy. At the time of writing, Russia is also about to set up a second register and France is replacing its offshore register (Kerguelen) with a second register. Conditions of entry differ, but the principal aim is similar to that of the offshore register: the national flag may be flown without some of the restrictions that otherwise entails. However, unlike the accidental development of some of the offshore registers in established offshore financial centres, the international registers are entirely creatures of expediency, established in a conscious effort to attract tonnage back from the open registers.

Statistics reveal the rise of the open registers. Exhibit 1.1 shows the world's 10 largest fleets, by gross registered tonnage (grt), at five-yearly intervals since 1974.<sup>6</sup> The rise of the open registers will be apparent, though it is worth noting the continuing significant market shares of some of the traditional maritime nations, notably Greece, Japan and, until recently, the United States. The Greek situation is worthy of note, for some time ago Greece took

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positive steps to arrest the trend towards flagging out. Although Greek owners have been no more immune than others to the economic pressures of the shipping industry since the Second World War, and many Greek owners have flagged out, particularly to Cyprus, successive Greek governments have sought, by the use of fiscal incentives, to maintain the use of the Greek flag by Greek owners.

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### Exhibit 1.1

#### The world's top 10 registered fleets by grt – 1974 to 2004

##### 1974

1	Liberia	55,321,641
2	Japan	38,707,659
3	UK	31,566,298
4	Norway	24,852,917
5	Greece	21,759,449
6	USSR	18,175,918
7	USA	14,429,076
8	Panama	11,003,227
9	Italy	9,722,015
10	France	8,834,519

##### 1979

1	Liberia	81,528,175
2	Japan	39,992,925
3	Greece	37,352,597
4	UK	27,951,342
5	USSR	22,900,201
6	Norway	22,349,337
7	Panama	22,323,931
8	USA	17,542,220
9	France	11,945,837
10	Italy	11,694,872

##### 1984

1	Liberia	62,024,700
2	Japan	40,358,749
3	Panama	37,244,233
4	Greece	35,058,593
5	USSR	24,492,469
6	USA	19,291,868
7	Norway	17,662,916
8	UK	15,874,062
9	PRC	9,300,358
10	Italy	9,157,867

(Continued)

## Exhibit 1.1 (Continued)

**1989**

1	Liberia	47,892,529
2	Panama	47,365,362
3	Japan	28,030,425
4	USSR	25,853,712
5	Greece	21,324,340
6	USA	20,587,812
7	Cyprus	18,134,011
8	Norway	15,596,900
9	PRC	13,513,578
10	Bahamas	11,578,891

**1994**

1	Panama	64,170,219
2	Liberia	57,647,708
3	Greece	30,161,758
4	Cyprus	23,292,954
5	Bahamas	22,915,349
6	Japan	22,101,606
7	Norway (NIS)	19,976,489
8	Russia	16,503,871
9	PRC	15,826,688
10	Malta	15,455,370

**1999**

1	Panama	99,749,102
2	Liberia	57,179,231
3	Malta	25,518,507
4	Bahamas	25,478,573
5	Greece	24,251,781
6	Cyprus	22,239,967
7	Singapore	21,126,078
8	Norway (NIS)	18,428,456
9	Japan	14,538,938
10	USA	14,252,729

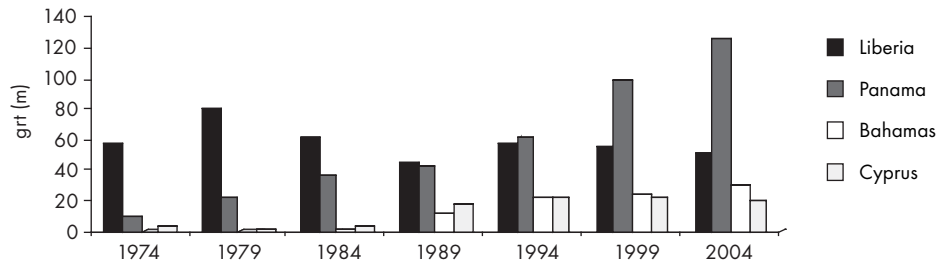
**2004**

1	Panama	127,753,074
2	Liberia	52,229,133
3	Bahamas	32,706,405
4	Greece	32,035,847
5	Hong Kong	25,405,871
6	Singapore	24,975,904
7	Malta	21,972,693
8	Marshall Islands	21,949,834
9	Cyprus	20,525,024
10	PRC	18,015,105

Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; Lloyd's Register of Shipping World Fleet Statistics 1993 and 1994; Lloyds Register Fairplay data, 2006.

Exhibit 1.2

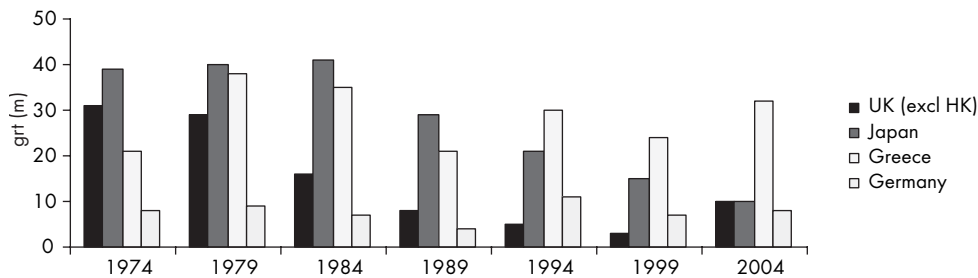
**The world's four largest open registers by grt 1974–2004**



Sources: *Lloyd's Register of Shipping Statistical Tables* 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

Exhibit 1.3

**Four traditional maritime nations grt 1974–2004**

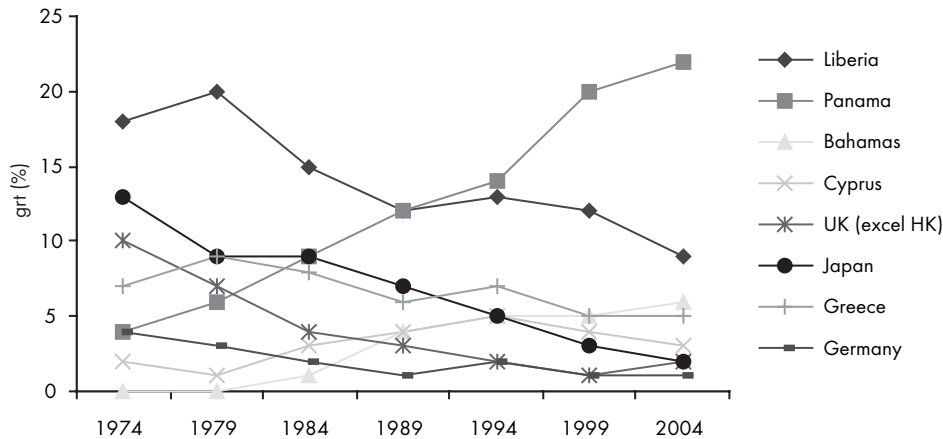


Sources: *Lloyd's Register of Shipping Statistical Tables* 1991 and 1992; *Lloyd's Register of Shipping World Fleet Statistics* 1993 and 1994; *Lloyd's Register of Fairplay Data*, 2006.

Exhibit 1.2 shows, by way of illustration, the record of the four largest open registers – Liberia, Panama, Cyprus and the Bahamas. The dramatic rise of the Bahamas is very noticeable, as is the continuing rise of Panama. By way of contrast, Exhibit 1.3 shows the relative performance of four traditional maritime nations; Japan, the United Kingdom, Greece and the Federal Republic of Germany. The relative stability of the Greek flag, under generally pro-shipping governments has already been noted; the demise of UK flag shipping, under a series of governments which have consistently adopted a non-interventionist shipping policy, is readily apparent although there has been a marked growth in the last five years shown, perhaps due to the UK tonnage tax scheme. In each case, the figures shown are for the gross registered tonnage registered under that flag in the years in question.

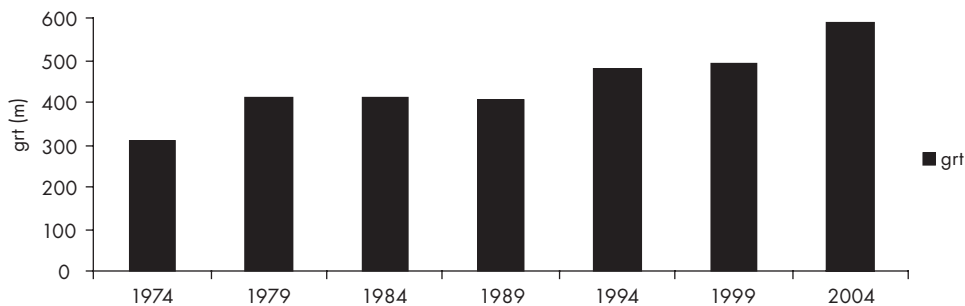
Exhibit 1.4 compares all eight nations in terms of percentage of the world fleet (again by grt) and, for the sake of completeness, Exhibit 1.5 shows the changing size of the world fleet during the same period. The moral is clear. The economics of lower operating costs prevail over the fine words of the UN Conventions. It is also of interest to note the average

Exhibit 1.4  
Comparative percentage of world fleet by grt 1974–2004



Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; Lloyd's Register of Shipping World Fleet Statistics 1993 and 1994; Lloyd's Register of Fairplay Data, 2006.

Exhibit 1.5  
Changing size of world fleet by grt 1974–2004



Sources: Lloyd's Register of Shipping Statistical Tables 1991 and 1992; Lloyd's Register of Shipping World Fleet Statistics 1993 and 1994; Lloyd's Register of Fairplay Data, 2006.

age of vessel on the world's registers. Singapore (11 years) and Liberia, Hong Kong and the Marshall Islands (12 years) have the youngest fleets. Traditional national registers such as Sweden (30 years), Finland (31 years) and Canada (29 years) are among the oldest, and the Isle of Man (10 years) is the youngest of all. An understanding of these basic facts of shipping life is essential for anyone operating in shipping finance. Later on, we will look at some of the more detailed requirements of the various registries.<sup>6</sup> What, though, is the significance of the flag of a ship for a lender?

The basic answer is that the law of the flag will invariably govern the mortgage which will be a fundamental part of the lender's security. Again, detailed consideration of the mortgage laws of the principal ship registration jurisdictions will come in Chapter 7, but the crucial question for a lender will always be whether the mortgage will give the lender the security he requires. A lender will also always be concerned to ensure that the ship satisfies the requirements of the flag state. If it does not, the registration will be liable to be avoided and with it may go the lender's mortgage. Other factors for a lender will be the extent of any regulatory requirements with which the owner will need to comply as a result of having his ship registered on the flag in question – for example, a Cyprus ship must be owned by a Cypriot or a Cypriot company, and the lender will be concerned to ensure that a Cypriot owning company has suitable offshore status to allow it to service foreign currency debt.

The policy adopted by lenders differs. Some will have no concern about the flag flown by the vessel, so long as they are convinced, perhaps on the strength of an opinion from a local lawyer, that their security by way of registered mortgage is adequate. Others, with the same end in mind, will turn down without question ships not registered on certain registers with a proven track record of security enforcement by mortgagees.

Lenders should, however, look rather further than this. For example, a lender should consider whether the vessel's flag state will impose and enforce acceptable safety and technical standards. This is especially true, as we have seen, following the introduction of first the ISM Code and then the ISPS Code. A lender will, generally speaking, be looking to the ship's earning capacity as the primary source of the debt service, and will be none too keen to have the ship delayed or detained because of failure to meet acceptable technical standards. He will also need to consider the way in which the legal system of the flag state deals with maritime liens: in some countries a wide range of claims against the vessel will take priority to the rights of a mortgagee on a forced sale.<sup>7</sup> Lastly, the political stability of the flag state may be an issue.

### **Bareboat charter registration**

Bareboat or demise charter registration, frequently known as parallel registration, is a system that has developed in certain (though by no means all) countries. It allows the registration of a vessel in that country to be temporarily suspended for the duration of a bareboat, or demise charter, with the vessel being registered in the name of the charterer on an alternative register for the duration of the charter, during which time it may fly the flag of the charterer's chosen register.

The precise conditions on which different countries permit bareboat charter registration out from, or in to, their ship registers vary, and are detailed in Chapter 11. However, some of the relevant features are listed below.

- The owner's title remains registered on the primary register, his registration being not terminated, but merely suspended.
- Similarly, mortgages will remain registered on the primary register. Mortgagees' consent will usually be required for any bareboat charter registration, but there is frequently no procedure for the mortgage to be registered or even noted on the secondary register – as the vessel will be flying the flag of the country of the secondary register third parties will be

unaware of the country of the primary register. This lack of transparency can create concern for lenders, even though their security rights should not be adversely affected.

- As mentioned above, the vessel will fly the flag of the country of the secondary register for the duration of the bareboat charter (though sometimes subject to periodic renewal of the temporary registration during the life of the charter).

Charterers of vessels let on bareboat charter may require the vessel to be temporarily registered on the register of their choice. This is particularly important (a) where specific cargoes or geographical trades are limited to vessels flying certain flags; (b) in leasing transactions where the lessee/charterer will not want the choice of the vessel's flag to be determined by any mandatory requirements of the lessor's country of incorporation; and (c) where the country of the charterer's chosen register does not have a system of mortgage registration considered adequate by international banks – financing through bareboat charter registration (that is, lending to a single ship company in an acceptable jurisdiction then permitting bareboat charter registration by the ultimate shipowner, as bareboat charterer, in a less acceptable jurisdiction) can resolve this issue.

### The one-ship company

Apart from 'flag of convenience', the other shipping term with which many laymen will be familiar is 'one-ship company'. Commonly, though by no means invariably, a shipowner will establish a separate company to own each ship in his fleet. Occasionally, this will be dictated by the requirements of the flag – for example, the requirement (generally speaking) for a Liberian ship to be owned by a Liberian company will mean that the ship will necessarily be in separate ownership from a Cyprus flag ship in the same ultimate ownership, which must be owned by a Cypriot company. There may be administrative or fiscal advantages. However, the main reason relates to arrest.

The International Convention relating to the Arrest of Seagoing Ships was signed on behalf of the United Kingdom in 1952. Article 3 of the convention provides that 'a claimant may arrest either the particular ship in respect of which the maritime claim arose, or any other ship which is owned by the person who was, at the time when the maritime claim arose, the owner of the particular ship'. Article 3 was introduced into English law by the Administration of Justice Act 1956. The current English law on what has come to be known commonly as 'sister ship arrest' is found in Section 21 of the Supreme Court Act 1981. This provides that:

[...] in the case of any such claim as is mentioned in Section 20 (2) (e) to (r),<sup>8</sup> where:

- (a) the claim arises in connection with a ship; and
- (b) the person who would be liable on a claim on an action *in personam* ('the relevant person') was, when the cause of action arose, the owner or charterer of, or in possession or control of, the ship, an action *in rem*<sup>9</sup> may (whether or not the claim gives rise to a maritime lien on that ship) be brought in the High Court against:
  - (i) that ship, if at the time when the action is brought the relevant person is either the beneficial owner of that ship as respects all the shares in it or the charterer of it under a charter by demise; or

- (ii) any other ship of which, at the time when the action is brought, the relevant person is the beneficial owner as respects all the shares in it.

In other words a claimant is not restricted to arresting the ship against which his claim arose, but may also arrest any other ship in the same beneficial ownership when the action was brought. Most other maritime jurisdictions have similar provisions. Some, for example South Africa, have even more extensive sister ship arrest rights.

The obvious solution, therefore, is to register each ship in a particular owner's fleet in the name of a different company, each company being a subsidiary of the parent company or owned by the individual shipowner. Certainly in English law, the separate legal personality of each company is sufficient to prevent a ship owned by one of these one-ship companies being arrested for claims against other ships in the same group. This was tested as recently as 1988, when the Court of Appeal gave judgment in the case of the 'EVPO AGNIC'.<sup>10</sup> The then Master of the Rolls, Lord Donaldson of Lynton, summarised the position as follows.

The truth of the matter, as I see it, is that Section 21 [of the Supreme Court Act 1981] does not go, and is not intended to go, nearly far enough to give the plaintiffs a right of arresting a ship which is not the 'particular ship' or a sister ship, but the ship of a sister company of the owners of the 'particular ship'.<sup>11</sup>

He drew an important distinction between the beneficial ownership of the ship and the beneficial ownership of the shares in the owning company, holding that the ship (owned by a traditional one-ship company) was both legally and beneficially owned by that company and that:

[...] any division between legal and equitable interests occurs in relation to the registered owner itself, which is almost always a juridical person. The legal property in its shares may well be held by A and the equitable property by B, but this does not affect the ownership of the ship or of the shares in that ship. They are the legal and equitable property of the Company.<sup>12</sup>

The use of the one-ship company has two principal implications for lenders. The first is an advantage. It makes the mortgaged ship immune from arrest for claims against other ships in the owner's fleet (though if the lender has secured himself by mortgages on all the ships in the fleet this advantage disappears). No lender wishes the earning capacity of a mortgaged ship to be adversely affected as a result of a claim totally unrelated to that ship.

The second implication is that the lender will be lending to a borrower with no assets of any consequence other than the ship. Apart from the ship (and its insurances and earnings) the borrower will be unable to offer any other assets to the lender by way of security or as a source of income for debt repayment and service.

This makes the enforceability of the mortgage of crucial importance. It also means that the lender must look elsewhere for additional security, often by way of a guarantee from the ultimate parent of the one-ship company, perhaps backed by security over its assets. An alternative approach, sometimes used for large corporate groups, is for the lender to lend to the parent and to take guarantees from each shipowning subsidiary, those guarantees being backed

by mortgages over the owning companies' vessels. Where one-ship companies are used, shipping finance is asset finance in the narrowest sense of the term because if the ship, for whatever reason, disappears the lender will, for all practical purposes, have no recourse to the borrower and will be left to look to his secondary lines of security.

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- <sup>1</sup> Lord Justice Roskill, the 'PANGLOBAL FRIENDSHIP' [1978] 1 Lloyd's Rep. 368 @ 371.
- <sup>2</sup> See Chapter 2.
- <sup>3</sup> See Section 9 of The Merchant Shipping Act 1995 and Regulations 7 and 8 of The Merchant Shipping (Registration of Ships) Regulations 1993, Regulation 7 as amended by The Merchant Shipping (Registration of Ships) (Amendment) Regulations 1998, which came into force on 1 January 1999 and the British Overseas Territories Act 2002, which came into force on 26 February 2002 and Regulation 8 as amended by The Merchant Shipping (Registration of Ships) (Amendment) Regulations 1994.
- <sup>4</sup> The International Management Code for the Safe Management of Ships and for Pollution Prevention, as adopted by the Assembly of the International Maritime Organisation on 4 November 1993 by Resolution A.741 (18) and incorporated on 19 May 1994 as Chapter X of the Safety of Life at Sea Convention 1974.
- <sup>5</sup> The International Ship and Port Security Code as adopted by the Conference of Contracting Governments to the Safety of Life at Sea Convention 1974 on 13 January 2002 and incorporated as Chapter XI-2 of the Safety of Life at Sea Convention 1974.
- <sup>6</sup> See Chapter 11.
- <sup>7</sup> For further details see Chapter 7.
- <sup>8</sup> These categories include (among others) claims such as claims for general average, disbursements, crew wages, salvage, towage, damage done by the ship and loss or damage to goods carried on board.
- <sup>9</sup> Hence the right to arrest.
- <sup>10</sup> [1988] 2 Lloyd's Rep. 411.
- <sup>11</sup> Ibid., 415.
- <sup>12</sup> Ibid., 415.