

ENFORCEMENT OF MARINE MORTGAGES

Enforcement remedies available to holders of marine mortgages are established in the Canada Shipping Act and in the Federal Court Act and its procedural rules and may be supplemented by contractual provisions between the parties, usually found in the Deed of Covenants. The following are the enforcement mechanisms available to a statutory marine mortgagee at law.

Mortgagee in Possession

When default occurs under the terms of the mortgage, the lender has the right to take possession of the vessel and thereafter operate it as a "mortgagee in possession". The only procedural requirement which must be satisfied by the lender taking possession of the vessel is the filing of an Appointment of Managing Owner form with the appropriate Registry of Shipping. However, the lender must also make arrangements to ensure that the vessel is properly operated and managed while the lender is in possession. The disadvantage to this enforcement mechanism is that the lender may be held accountable to both the borrower and other creditors for questionable managerial and operational decisions.

Sale of Vessel

A mortgagee has two alternative mechanisms by which it may sell the vessel:

- (a) It may exercise the mortgagee's absolute power of sale pursuant to section 51 of the Canada Shipping Act. Section 51 provides as follows:

Every registered mortgagee has power absolutely to dispose of the ship or share in respect of which he is registered, and to give effectual receipts for the purchase money, but where there are more persons than one registered as mortgagees of the same ship or share, a subsequent mortgagee shall not, except under the order of the court of competent jurisdiction, sell the ship or share without the concurrence of every prior mortgagee.

- (b) It may commence action in the Federal Court of Canada and invoke the appraisalment and sale procedure set out in Rule 1007(1), which provides:

The court may, either before or after final judgment, order any property under the arrest of the court to be appraised, or to be sold with or without appraisalment and either by public auction or by private contract, and may direct what notice by advertisement or otherwise shall be given or may dispense with the same.

Absolute Power of Sale Pursuant to Canada Shipping Act

Proceeding in this manner is quick and simple, in that the sale is accomplished by execution of a Bill of Sale by the mortgagee in favour of the purchaser. However, this procedure has the following drawbacks:

- (a) The lender must take its own initiative to seek out potential purchasers;
- (b) The right of sale cannot be exercised when the vessel is under arrest by any other creditor;
- (c) The lender has extreme accountability to any subsequent mortgagees who have not consented to the sale, to other creditors and to the owner, any of which may question the sufficiency of the sale price. As such, a mortgagee selling pursuant to section 51 of the Canada Shipping Act must take reasonable steps and precautions to obtain a proper price for the vessel. It is prudent to obtain at least two independent valuations from qualified appraisers before selling. Lower ranking creditors and the owner will frequently focus upon the mortgagee's efforts and may attempt to hold it liable for the difference between the vessel's sale price and what they suggest a reasonably obtainable price should be.
- (d) A mortgagee who exercises the section 51 right to sell the vessel can only give as good a title as the owner itself held. Pre-existing maritime liens will not be removed by such a sale, and any purchaser may expect the mortgagee to provide an indemnity with respect to any claims which may arise against the vessel as a result of encumbrances, or incidents giving rise to encumbrances, pre-dating the conveyance.

Unless a mortgagee is familiar with the history of a vessel's operations and is confident that he is obtaining the best reasonably possible price, there is significant exposure in following the section 51 sale route. Where substantial monies are involved, mortgagees are usually well advised to follow the safer Federal Court sales procedure.

Federal Court Action

The Federal Court requirements to effect sale are flexible, the only absolute prerequisite being that an action must first be commenced in that Court by the mortgagee (or any other creditor) and an arrest Warrant issued and served. The Court ordered sale may be either by public auction or tender, or by private contract.

Action is commenced by filing a Statement of Claim. Simultaneously a mortgagee can make ex parte application for a Warrant for the arrest of the vessel. The Statement of Claim and Affidavit in support of the Warrant should detail particulars with respect to the vessel and her owner, the debt, the security and the amount currently outstanding.

As a matter of law, the mortgagee is not automatically vested with possession of the vessel at the time of the arrest, nor is the Marshal of the Federal Court (typically the Sheriff) who arrests the vessel. Technically, possession and all the obligations of preservation and maintenance remain with the person who was responsible immediately before the arrest. For practical purposes, however, the lender should be prepared to act as required to protect its security when the vessel is placed under arrest, as it may be abandoned by its owner.

If the lender wishes to take possession of the vessel or to place the Marshal in possession, it may make application to the Court to do so. The lender will likely be required to provide the Court with an undertaking to ensure proper care of the vessel, including providing insurance coverage while it remains under arrest. The advantage of such a step is that the lender is able to ensure the proper care and maintenance of the vessel, and the Court Order placing it in possession will typically direct that costs incurred by the lender (or by the Marshal, who may bill the lender at first instance) in caring for and maintaining the vessel will constitute a first charge on the eventual proceeds of sale.

Once the jurisdiction of the Federal Court has been achieved by the arrest, the mortgagee may apply for an Order for sale of the vessel. This Order may be obtained either before or after final judgment against the owner, although an application before judgment may be denied if there is a dispute as to the indebtedness. If the claim is not defended within 30 days after service of the Statement of Claim, the mortgagee may apply for judgment by default and simultaneously obtain an Order for Sale.

The mortgagee has the option to seek to proceed with the sale either by way of public auction/tender, or by private contract.

Public Sale

When the auction or tender route is followed, the Court issues a commission addressed to the Marshal of the Federal Court to undertake a sale to the highest bidder. The Court may also direct that a detailed appraisal be provided by an appropriately qualified individual, which is normally arranged by the mortgagee. The Court directs appropriate advertising of a request for sealed tenders, usually returnable after about six weeks, or the advertising of a date for a public auction. This is typically published in local newspapers, or in the case of more valuable vessels in national or international papers or trade journals. Subject to the amount of the highest bid being reasonable having regard to the appraised value of the vessel, the vessel would normally be sold by the Court to the highest bidder upon a further application for approval of the sale after the tendering process or auction has been concluded. The Court does have discretion to seek additional tenders or to require the repetition of the process if it considers such to be appropriate.

Private Contract

In the case of sale by private contract, the procedure in the Federal Court is similar up to the point where the order for sale is obtained. Then, instead of requesting the Court to authorize advertising of the sale, the lender presents the Court with a detailed offer from a prospective purchaser. The lender will privately have located the purchaser through its own efforts, or with the assistance of a broker, and will have negotiated tentative price and terms. The mortgagee then applies to the Court for an order for sale by private contract. Other interested parties are typically notified so that they may object if they feel the agreed price is too low.

The Court has wide discretion whether to approve the sale and is more likely to do so if the vessel is deteriorating or the market is uncertain. The contract sale procedure is recognized because Court ordered sales by tender or auction often bring lower bids than would otherwise have been negotiated privately.

A variation is provided for by Federal Court Rule 1007(2)(b), pursuant to which the Court may appoint a broker to locate a buyer and negotiate the best price possible. The broker reports back to both the Court and the mortgagee, and the Court ultimately decides (with input from the mortgagee and potentially other interested parties) whether the offer will be accepted.

The private sale approach can reduce sale time and cost significantly, as advertising is not required.

A mortgagee suggesting a private sale to the Court has a high level of responsibility to satisfy the Court that the maximum return will be achieved thereby. Typically a mortgagee must provide evidence of at least two detailed appraisals and expert opinions from brokers or appraisers indicating that the proposed contract price represents the best price reasonably obtainable.

Concluding the Sale and Post-Sale Procedures

In any Federal Court sale, whether public or by private contract, the conveyance is made by the Marshal as an officer of the Court and the lender is not further accountable for the amount received. Upon receiving the purchase price, the Marshal gives the purchaser a clean bill of sale, free from encumbrances, which he can provide to the appropriate Registry of Shipping so as to be reflected as the registered owner. Herein lies the most significant advantage of this particular sale process, in that the purchaser is assured of clear title, and neither he nor the lender who initiated the sale of the vessel has to worry about maritime liens or other encumbrances predating the sale.

The full purchase price is paid into Court and retained pending adjudication of priorities among the lender and other claimants, who are given an opportunity, following public advertising arranged by the lender's solicitor, to file documentation supporting their claims.

Following the sale, the Marshal will file a return of the Commission for Sale, and the Marshal's fees and expenses, and other Court approved fees and expenses associated with the sale will, subject to taxation, be paid first from the proceeds of sale. As discussed above, any care or maintenance expenses incurred by the mortgagee may, if approved in advance, also be afforded first priority. The Court will then decide on the remaining priorities, and the claimants including the mortgagee will be paid in appropriate order until the proceeds of sale are exhausted.

As a general rule, a statutory marine mortgages receives very high priority, subsequent only to expenses of the sort described above and maritime liens. However, for more detail on the system of priorities, see the paper entitled "Maritime Claims - How do they get Paid?" later in these materials.

VESSEL CONVEYANCING

The most common form of vessel conveyancing is obviously by way of purchase and sale, with which most of this portion of this paper will be concerned. However, another means is of course by will or intestate succession, upon the death of the vessel's owner, which will also be addressed briefly.

The three documents most fundamental to a vessel sale are the Agreement of Purchase and Sale, the Bill of Sale, and a Warranty and Indemnity Agreement. These will be discussed below, along with the ancillary documents that are involved in the sale of a registered vessel.

Agreement of Purchase and Sale

Obviously not all vessel purchases are preceded by an Agreement of Purchase and Sale. The likelihood of requiring such an agreement, and the complexity of its terms, are typically related to the value of the vessel involved. Of course, the agreement can consist of whatever terms may be negotiated between the parties. However, a commonly used precedent (a copy of which is attached to this material) is the Norwegian Shipowners' Association's Memorandum of Agreement for Sale and Purchase of Ships, which was adopted by the Baltic and International Maritime counsel (BIMCO) in 1956. This form has been revised a number of times since and the most recent version is entitled Saleform 1993.

Saleform 1993 is quite comprehensible, even to those who do not have extensive knowledge of the shipping industry, and addresses essential terms such as the purchase price, any applicable deposit, terms of payment, inspections (including possible drydocking and/or diving inspections), and the time and place of delivery. It also addresses responsibility to pay for bunkers (fuel) present on the vessel at the time of delivery, and taxes applicable to the transaction, as well as prescribing in generic terms the documentation that will be used to document the sale. Saleform 1993 includes a provision by which the seller warrants the vessel to be free from encumbrances and undertakes to indemnify the buyer any claims against the vessel incurred prior to the time of delivery. Also included are terms providing the consequences of default under the agreement by either the buyer or seller and an arbitration provision to address the adjudication of disputes.

Obviously Saleform 1993 can be modified and supplemented as necessary to reflect the requirements of the parties in each individual transaction.

Bill of Sale

As with the sale of any property, a Bill of Sale is used to document the transfer of title itself. The form of Bill of Sale used to document the sale of a vessel depends upon whether the vessel is registered or unregistered. If the vessel is registered under the Canada Shipping Act, a statutory form of Bill of Sale (a copy of which is attached to these materials) is employed. As with the statutory registration documents discussed earlier in this paper, the Bill of Sale contains

certain particulars of the ship, such as her name, official number, port of registry, tonnage and certain measurements, and contains language reflecting the transfer of title between the parties, the number of shares of the vessel that are being transferred and the applicable consideration. That the Registrar requires the address of the purchaser to be included in the Bill of Sale. However, the actual consideration need not be specified, in that it is acceptable to use language such as "one dollar and other valuable consideration". The statutory form of Bill of Sale also includes language by which the vendor covenants that it has power to transfer title to the shares in the vessel and that these are free from encumbrances other than as expressly provided. Requirements for filing the statutory Bill of Sale will be discussed below.

For an unregistered vessel, there is no particular form of Bill of Sale which the parties must employ. The terms are simply drafted to reflect the requirements of the transaction and will not necessarily be dissimilar to the terms used in conveyance of any other non-marine chattel. However, it is typical to make explicit reference in the Bill of Sale to the items of property being conveyed so that, if this includes not only the vessel but also particular equipment, tackle, fishing gear or other appurtenances thereto, these are explicitly identified, either in the Bill of Sale or a schedule thereto. As with the statutory Bill of Sale, it is typical to include a covenant to the effect that the vendor has power to transfer the vessel and that the vessel is free from encumbrances other than as expressly described.

If a vessel is not registered but is licensed under the Canada Shipping Act, it is necessary for the vendor to complete the section on the reverse of the license which reflects the transfer in title, similar to the process involved in transferring registration of a motor vehicle. The purchaser may also be required to complete a new application for vessel license form. The administration of this documentation is handled by the Customs and Excise branch of Revenue Canada.

Warranty and Indemnity Agreement

Notwithstanding that the purchaser of a vessel may have conducted comprehensive searches of the sort described below, it is impossible to determine with certainty that there are no liens or encumbrances against the vessel which could survive the transfer of title, particularly given the possibility of the existence of maritime liens. Maritime liens are liens that attach to a vessel as a result of certain categories of incidents or debts involving the vessel, which both have a very high level of priority and which survive a conveyance. Maritime liens can arise as a result of damage caused by the ship in collision or can relate to a debt outstanding to a salvor relating to salvage of the ship or to master and crew for past services. Unless a purchaser of a vessel is fully conversant with the history of the vessel's operations and accounts, there is always a danger that the purchaser may have to pay a claim or debt relating to the period prior to conveyance, in order to prevent or respond to an arrest of the vessel pursuant to the resultant maritime lien.

This concern is often addressed by means of a Warranty and Indemnity Agreement, by which the vendor warrants and covenants that the vessel is free from all liens and encumbrances and undertakes to indemnify the purchaser in the event that a lien or encumbrance may surface. More detailed versions of such agreements may expressly refer to, and deny the existence of, various categories of liens and activities or incidents which could give rise to liens. It is also common for the indemnification portion not only to hold the purchaser harmless against liens and encumbrances and all costs and expenses associated with the defence of such, but also to include an undertaking by the vendor, at its sole expense to discharge any such liens or encumbrances that should arise and, in the event that they are sought to be enforced by way of arrest or attachment, to provide security to free the vessel from such arrest.

Statutory Documents - Conveyance of Registered Vessel

As described above, the document which evidences the transfer of title of a registered vessel is a statutory Bill of Sale. This is filed with the Registrar of Shipping for the port in which the vessel is registered along with an appropriate filing fee, which is based upon the vessel's tonnage. This form must also be accompanied by two additional statutory forms, a Declaration of Ownership and an Appointment of Managing Owner or Manager (copies of which are attached to this paper).

The Declaration of Ownership must be sworn by the new owner before a barrister, commission of oaths, notary public or other officer authorized to take oaths in the jurisdiction in which the document is sworn. In essence, it consists of a statement that the signatory is entitled to be registered owner of the vessel and that no unqualified person is entitled as owner to any legal or beneficial interest in the ship or any share therein. The purpose of this document is to ensure compliance with the citizenship and/or incorporation qualifications for an owner of a ship registered in Canada, as prescribed by section 6 of the Canada Shipping Act, are complied with. In the event that the vessel is purchased by more than one person, individual or corporate, either by splitting the shares in the vessel or by purchasing joint interests in the shares, each owner must swear a separate Declaration of Ownership.

The Appointment of Managing Owner or Manager is the form by which the new owner notifies the Registrar of Shipping of the name and address of whoever will be responsible for managing the vessel and whom the Registrar can contact as required for administrative purposes. In the event that the appointee is the owner (or one of the owners in the case of multiple ownership), the appointment is as "managing owner". Otherwise, the appointment is as "manager".

There is no fee for filing the Declaration of Ownership or Appointment forms.

It is not unusual for the new owner of a vessel to wish to change the vessel's name and/or port of registry. These changes can be accomplished by filing with the above documents a Notice of Change of Name and/or Declaration for Transfer of Registry. There is also a process by which the prospective purchaser can reserve the intended name in advance of the actual conveyance (assuming that name is not already in use), akin to the process for reservation of a corporate name through the Nova Scotia Companies Office.

When filing with the Registry the statutory forms which document a transfer of title, it is customary to provide the Certificate of Registry for endorsement by the Registrar to reflect the new ownership. The Certificate of Registry (often called the Bluebook) is typically retained on board the vessel in order to provide proof of registration and ownership.

Conveyance Upon Death of Registered Owner

If the conveyance of title to a registered vessel is pursuant to the will of the owner, or by intestate succession, the set of documentation which must be provided to the Registry of Shipping differs somewhat from the case of a sale. The Registry will require certified copies of the owner's Death Certificate and Letters Probate, attaching a copy of the will, or Letters of Administration, as applicable.

The statutory form used to document the transfer of title to the executor or administrator is a Declaration of Transmission which, like the Declaration of Ownership, is a sworn statement by the executor or administrator that he or she is qualified to own shares in the vessel and states the manner by which title has been transmitted, ie. a reference to the will or intestacy. A copy of a Declaration of Transmission is attached to this paper. The executor or administrator must also file an Appointment of Managing Owner or Manager. If the executor or administrator then wishes to further convey title to the vessel, this can be done using the Bill of Sale and ancillary documentation in the normal manner.

Searches

The following are the searches which may be performed by the prospective purchaser or its counsel prior to sale, in order to identify liens and encumbrances against the vessel. Not all the searches would be performed in all transactions, and the comprehensiveness of the search process of course depends upon the value of the vessel, the purchaser's knowledge of the vessel's history and its resultant level of comfort with the transaction. It should be borne in mind that there is no registry for maritime liens and accordingly, even if all the following searches are performed, there is no means of determining with certainty that the vessel is not subject to maritime liens arising from past incidents or debts.

Registry of Shipping

Employing the vessel's name, port of registry and official number, a Transcript of Registry can be requested from the Registrar of Shipping at the port where the vessel is registered, which will indicate the registered ownership and whether there are any statutory marine mortgages against the vessel.

Federal Court

It is typical to request that the office of the Registry of the Federal Court of Canada perform a search to identify any actions against either the vessel itself or the vendor. If an action in rem has been commenced against a vessel prior to its conveyance, the statutory lien represented by the in rem claim against the vessel will survive the conveyance. This is also a means by which maritime liens can sometimes be identified.

Bankruptcy and Insolvency Act

A search of the records of the Bankruptcy Branch of Industry Canada, against the name of the vendor, can be requested by fax.

Bank Act

A search against the name of the vendor in the records of the Bank of Canada will identify any existing security against the vessel pursuant to section 427 of the Bank Act.

Corporations Securities Registration Act

In the past, it has been typical, in the context of a vessel conveyed by a corporate vendor, to search under the Corporations Securities Registration Act for debentures against the company which could arguably encumber the vessel. This registration system is of course being replaced by the new Nova Scotia Personal Property Security Act, although under that statute's transitional provisions, it will be necessary to continue these searches until November 3, 2000.

Workers' Compensation Act

An inquiry may be made of the Nova Scotia Workers' Compensation Board, to determine whether the vendor, if a registered employer under the Act, is in good standing. This is intended to identify any assessments owing by the vendor to the Board which could constitute a lien against the vessel.

Labour Standards Code

Similarly, if the vendor is an employer, an inquiry can be made of the Department of Labour to identify any outstanding complaints which could result in a lien against the vessel.

Health Services Tax Act

If the vendor of the vessel has in the past been a registered vendor under the Nova Scotia Health Services Tax Act, an inquiry can be made of the Provincial Tax Commission to identify whether any tax payments are outstanding which could result in a lien against the vessel. Such an inquiry requires the vendor to sign a consent form provided by the Commission, which references the vendor's registration number. There is at present no way to search for Harmonized Sales Tax payments that may be outstanding under the Revenue Act.

Chattel Searches

In the past, it has not been unusual, particularly when conveying a vessel of any significant value, to perform chattel searches against the vendor's name under the Bills of Sale Act and Conditional Sales Act, in the appropriate counties, in order to identify any security instruments that may have been registered under those statutes. This is done as a matter of due diligence and as an abundance of caution, even though, in the case of a registered vessel, it would be unusual to register security under these statutes.

Under the new Nova Scotia Personal Property Security Act, and its transitional provisions, it will be necessary to continue these searches until November 3, 2000. As well, a search under the vendor's name should now be conducted in the PPSA registry.

Sheriff's Office

It is common to make an inquiry of the Sheriff's office in the County of the vendor's residence or of the vessel's home port, to attempt to identify any execution orders against the vendor which could affect the vessel.