

“MARITIME RISKS AND CREDITS: FINANCERS AND GUARANTORS. SHOULD THEY PLAY OR SHOULD THEY STAND BEHIND THE OWNER?”*

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I. Introduction

As a matter of tradition, financiers and guarantors are not directly involved in liability matters, since their activity consists of providing funds for the shipping business, mainly on ship's finance, and to get enough and secure guarantee for their payment. Therefore, they do normally stay behind the owner and do not play a direct role, as regards to liability matters is concerned.

In particular cases, so as the carriage of oil or hazardous materials, they provide guarantees for the owner under the regimes of the CLC and HNS Conventions. The position is similar for hull insurers in respect of salvage and general average guarantees. Guarantors also normally stay behind the owner and do not play a direct role in liability matters.

Shipowner's liability, on its different approaches, is – on the contrary -, a threat for financiers and guarantors, since it goes to diminish the value of the main asset of their debtor: the ship.

Traditionally, the ship mortgage has been the means for the financier to get security on his credit. In modern times, the leasing on ships has also become an important way to implement proper financing and security in the market. Both mortgages and leasing are focused on the ship herself, so that she remains as enough security of repayment, as long as she is in good seaworthiness conditions. Collateral securities may be needed, and are normally required, to secure the debt.

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However, both named instruments, as security for credits, have always been in contrast with maritime liens, where certain maritime related credits take precedence over the mortgage and the lessor's rights.

The tendency of all maritime conventions related with the shipowner's liability is to strengthen his liability and to establish higher monetary limits. Both aspects affect even more the security of financiers for their credits.

Our purpose is to raise some particular questions about the role of financiers and guarantors, as regards to:

- Interested parties in the process of drafting new regulations and/or international conventions on ship mortgage and maritime liens regimes.
- Legitimate parties in actions for shipowner's liability.

II. Maritime liens vs. Mortgages

The ship's mortgage, as a mean of security for the financier, is of great importance for the shipping industry, since it facilitates the raising of enough funds to either maintain or increase the owner's fleet. Therefore, it is important to give enough stability and an international and uniform legal status to mortgages, to provide confidence to financiers.

However, the existence of maritime liens, and their precedence as privileged credits over the mortgage, is linked to the very core of the Maritime Law, and particularly, to the concept of "maritime adventure". Normally, the credits that give rise to a maritime lien are those closely related to the maritime adventure and deemed necessary to its success. Since the success of the maritime adventure also means the preservation of the ship, as the financier's main security for his credit, it constitutes the traditional justification for the maritime liens to take precedence over the mortgage.

The last attempt to unify the law relating to maritime liens and mortgages is the International Convention on Maritime Liens and Mortgages, signed at Geneva on the 6th of May, 1993.

Its precedent is the International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, done in Brussels on the 27th of May, 1967, that never gained enough international support for its entry into force.

A. The 1926 Liens and Mortgages Convention

Their predecessor is the International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, signed at Brussels on the 10th of May, 1926. This convention lists the following maritime liens as with precedence over mortgages:

1. Court costs and related costs: (i) Law costs due to the State; (ii) Expenses incurred in the common interest of the creditors in order to preserve the vessel or to procure its sale and the distribution of the proceeds of sale.

2. Public taxes or charges: (i) Tonnage dues; (ii) light or harbour dues, and (iii) other public taxes and charges of the same character.
3. Pilotage dues: (i) Pilotage dues; (ii) the cost of watching and preservation from the time of the entry of the vessel into the last port.
4. Seamen's and Master's Liens: Claims arising out of the contract of engagement of the master, crew, and other persons hired on board.
5. Salvage and General Average: (i) Remuneration for assistance and salvage; and (ii) the contribution of the vessel in general average.
6. Indemnity Liabilities: (i) Indemnities for collisions or other accidents of navigation, as also for damage caused to works forming part of harbours, docks, and navigable ways; (ii) Indemnities for personal injury to passengers or crew; (iii) Indemnities for loss of or damage to cargo or baggage.
7. Supplier's or necessities lien: Claims resulting from contracts entered into or acts done by the master, acting within the scope of his authority, away from the vessel's home port, where such contracts or acts are necessary for the preservation of the vessel or the continuation of its voyage, whether the master is or is not at the same time owner of the vessel, and whether the claim is his own or that of ship-chandlers, repairers, lenders, or other contractual creditors.

B. The 1993 Liens and Mortgages Convention

The 1993 Convention reduced the number of maritime liens taking precedence before mortgages, in favour of ship's financiers, by submitting a new list of maritime liens, as follows:

1. Court costs: Including *custodia legis* expenses [art. 12(2)].
2. Seamen's and Master's Liens: [art. 4(1)(a)]
3. Indemnity Liabilities: (i) claims in respect of loss of life or personal injury occurring, whether on land or in water, in direct connection with the operation of the vessel [art. 4(1)(b)]; (ii) claims based on tort arising out of physical loss or damage caused by the operation of the vessel other than loss of or damage to cargo, containers and passengers' effects carried on the vessel [art. 4(1)(e)], but excluding damage in connection with the carriage of oil or HNS than might get compensation under other international conventions or national law [art. 4(2)(a)], and in connection with the radioactive properties or a combination of radioactive properties with toxic, explosive or other hazardous properties or nuclear fuel or of radioactive products or waste [art. 4(2)(b)].
4. Salvage: claims for reward for the salvage of the vessel [art. 4(1)(c)].
5. Public taxes or charges and Pilotage dues: claims for port, canal, and other waterway dues and pilotage dues [art. 4(1)(d)]

The main reform introduced by the 1993 Convention is to exclude the supplier's or necessities lien, at least as taking precedence over other liens, and most importantly, over ship's mortgages. Under article 6 of the Convention, a lien in favour of suppliers can be created by national law or statute, but it will rank after liens and mortgages listed in articles 1 and 4 of the Convention [see art. 6 (c)].

Greater debate has arisen as a result of the exclusion of the supplier's lien, as from the 1967 Convention proposed this particular change to the law of maritime liens. Two different views can be identified, and they are precisely summarized and exposed by Professor William Tetley, in the following terms:

"The historic purpose of a maritime lien (or the lesser statutory right in rem) for necessities was to permit the ship to proceed on its voyage whilst in some foreign port and out of touch with the shipowners. Thus supplied, the ship could complete its voyage, earn freight, pay its debts and benefit all the creditors.

"That ancient, almost romantic, situation no longer exists because of modern radio/telephone and facsimile systems. The master can easily communicate with the shipowners, as can the supplier, who can also investigate the shipowners' credit rating in order to make a reasonable decision as to whether to extend credit. The necessities man no longer requires a high ranking maritime lien".¹

However, it must be noted that the identification of the debtor is not always easy, due to the intervention of different persons in the running of the ship such as the registered owner, the disponent owner, charterers and subcharterers, and ship's operators and managers. Supplies and necessities are normally contracted for at the port by either the Master and/or the ship's agent, and due to the existence of the maritime lien, suppliers did not normally need to ask for their authority. The abolition of the maritime lien on supplies and necessities will certainly change the matter.

The debate is then open, to discuss if it is still valid, in present days, the concept of the maritime lien on supplies or necessities. We will see how successful is the ratification and the subsequent application of the 1993 Convention, in particular in front of some national law regimens that still contemplate the supplier's lien.

III. Guarantors for special cargoes

Banks and financing institutions are the very first interested persons in keeping the ship and the operating company (the borrower) afloat. In fact, the security of their debts very much depends on it.

On the other hand, there are ad-hoc specific guarantors in respect of certain ship's operations. It is the case of the guarantors of liability under CLC and HNS certificates.

A. The CLC 1992

Article VII of the International Convention on Civil Liability for Oil Pollution Damage, 1992 (CLC 1992) imposes to the owners of ships carrying more than 2,000 tons of oil in bulk as cargo the obligation to maintain either insurance or other financial security, such as the guarantee of a bank or a certificate delivered by an international compensation fund, in the

¹ Tetley, William; Maritime Liens and Claims, 2nd edition, Yvon Blais Internacional Shipping Publications, 1998, p. 617.

sums fixed by applying the limits prescribed in article V of the same convention, to cover his liability for pollution damage.

In addition, article V, rule 8, of the CLC 1992 provides that any claim for compensation for pollution damage may be brought directly against the insurer, or the other person providing security for the owner's liability for pollution damage, according to article VII.

The Convention goes on establishing that the guarantor will be able to limit his own liability according to article V, regardless of whether the shipowner himself has lost or retained his own right to limit. The guarantor is also entitled to the defences that the shipowner himself would have been entitled to invoke, as except for any bankruptcy defences. The guarantor will also be able to invoke as a defence that the pollution damage resulted from the willful misconduct of the shipowner.

B. The HNS Convention 1996

Under the auspices of the International Maritime Organization (IMO), in 1996 it was adopted the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (the "HNS Convention, 1996"), whose purpose is to establish a uniform international regime for the compensation for damage caused by the carriage by sea of hazardous and noxious substances (HNS).

This new regime established by the HNS Convention - not yet in force -, is largely modelled on the existing regime for oil pollution from tankers set up under the International Convention on Civil Liability for Oil Pollution Damage 1992 (CLC 1992) and the International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage 1992 (the "Fund Convention").

Apart from the provisions as to liability and limitation of liability, following the same two – tier system of the CLC 1992, we would like to note that the HNS Convention also imposes to the owner of a ship that carries HNS to take out insurance, or maintain other acceptable financial security to cover his liability under the HNS Convention.

As with the CLC 1992, the HNS Convention 1996 also provides for a direct action against the insurer or person providing financial security. The guarantor can also limit his own liability under the HNS Convention provisions, regardless of whether the shipowner himself has lost or retained his own right to limit. The guarantor will also be able to raise the defences that the shipowner himself would have been entitled to invoke.

C. A new liability regime for financiers and guarantors?

As we can see from both the CLC 1992 and the HSN Convention 1996, there is a clear tendency to involve financiers and guarantors in the shipowner's liability, by virtue of direct actions against them for claims arising out of damages covered by such regimes. Even though they are not directly involved in the ship's operations, their support as guarantors makes it possible for those operations to be carried out, which might be the possible grounds for their compromise as to liability.

This new approach to liability for maritime activities has the following features:

- Direct action against persons not involved in the operation of the ship, but intervening as guarantors of their activities, by virtue of a separate agreement with the shipowner.
- Guarantor's right to limitation of liability, independent of the shipowner's right to limit his own liability.
- Possibility for the guarantor to invoke shipowner's defences in front of the claimant, as except for any bankruptcy defence.
- A guarantor's defence based on the shipowner's willful misconduct.
- Possibility of the guarantor to require the shipowner to be joined in the proceedings.

The position of guarantors under both the CLC 1992 and the HSN Convention 1996 might well be assimilated to that of the hull insurers in respect of salvage and general average guarantees.

Recent oil pollution casualties have also brought the need for a future regime on guarantees in respect of "places of refuge".

D. Guarantor's compensation for victims is subject to the shipowner's liability

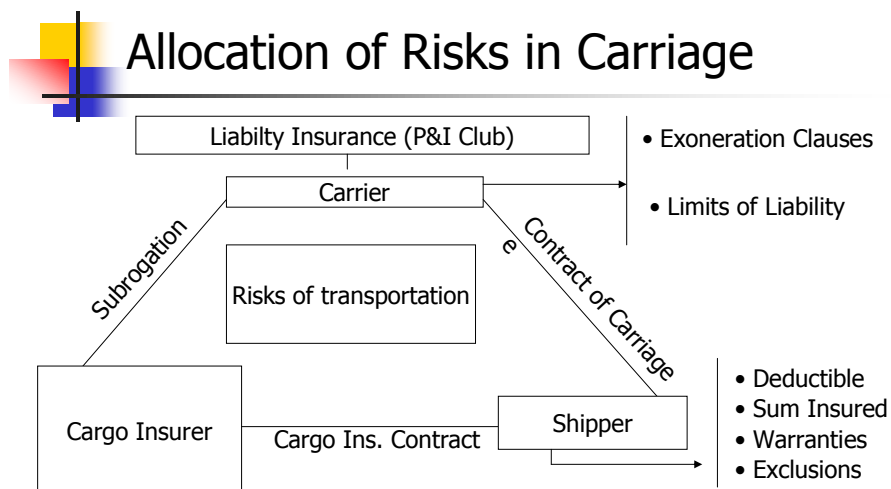
We have seen, however, that these "compulsory insurance", or "guarantee", or "other financial security", required by both the CLC 1992 and the HNS Convention 1996, are still subject to the determination of the liability of the shipowner, since such "guarantors" remain entitled to invoke the shipowner's defences in front of any victim's claim. Therefore, these "guarantees" are of a nature very similar to liability insurance.

This particular feature affects the desirable need to get a way for the prompt compensation for the victims, who are still facing the risk and delay of litigation, with all the problems linked to it, such as jurisdiction, applicable law, measure of damages, time bars, etc.

Making a parallel with cargo claims – where the cargo owners would play the position of victims of the damage -, they normally have in the cargo insurance a prompt recourse to get compensation, since the cargo insurance contract – obviously -, is not subject to the carrier's liability.

Once the cargo insurer pays a compensation to the cargo owner [the "victim"], he can sue the carrier [the shipowner, where such is the case] in a recovery action by way of subrogation. It is in this recovery action where all topics related to the carrier's/shipowner's liability are discussed.

The situation in relation with cargo claims can be illustrated as follows:



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Behind any liability regime there are economic and social interests trying to achieve a balance – a fair and equitable balance -, to share the risks they are exposed to.

In both the CLC 1992 and the HNS Convention 1996 there might be missing this “prompt way of getting compensation” favoring or at least alleviating the victim’s position. A mechanism whereby the victims would be able to get prompt but limited compensation from a “guarantor”, who would not then be allowed to invoke any shipowner’s defence. After such payment to the victims, this “guarantor” would be able to sue the owner in a recovery action by way of subrogation.

The system should have to be entirely based in an international convention, or by way of an statute, since it is clear that normally the polluter shipowner and the victims do not have a contractual relationship.

E. Points for reflection and/or debate

The situation at present, and the sight of future developments, let us raise several points for debate, as follows:

1. Would it be possible to create a mechanism allowing a prompt compensation to the victims of either oil pollution or a HNS event? A prompt – but limited – compensation whose payment is not subject to the shipowner’s liability?
2. This “prompt compensation mechanism” [the “guarantee”] could be provided either by insurers (different from liability insurers or P&I Clubs), by the banks, or by other financial institutions. But in any case also supported by the State, who has not only the right but also the duty to protect the environment.

3. Should this “guarantee” be a sort of a “demand guarantee” or “first requirement guarantee” regime², where the guarantor can not invoke the shipowner’s exceptions in front of the claimant, remaining these exceptions to be discussed in a different trial/proceeding as between shipowner and guarantor? The guarantor would only be able to invoke in front to the claimant any exception based on the guarantee agreement itself.
4. Upon payment, the shipowner’s defences would be left for a further litigation as between the shipowner and the guarantor, where the victims will not normally be involved, unless they would be willing to resign to the guarantee to pretend an amount in excess of the limited compensation provided by it.
5. This action between guarantor and shipowner would be a recovery action by way of subrogation, but based in either an international convention or a statute, since there is no contractual relationship at all between the polluter shipowner and the victims.
6. For this new recovery action, then, the shipowner can get the support of his P&I Club, as it is normally the case in the cargo claims.
7. Should this particular approach to shipowner’s liability be extended to hull insurers in respect of salvage and general average guarantees?
8. Should it be extended to the future need for guarantees in respect of “places of refuge”?
9. Should a new and distinct liability regimen for financiers and guarantors be envisaged?

The debate is open for the years to come, and much of it will depend on the application of the provisions on the subject contained in the CLC 1992 as well as in the HNS Convention 1996.

² See, ICC's Uniform Rules for Demand Guarantees (ICC Publication no. 458) (he "URDG" or "Rules")