

# Credit Based Upon Security in Ships

Thor Falkanger

<b>1</b>	<b>The Topics to be Discussed</b> .....	36
<b>2</b>	<b>The Security Concept, in Particular in Respect of the Mortgage – and the Legal Framework</b> .....	38
<b>3</b>	<b>Some Factual Risks Involved in Having a Ship as Security</b> .....	39
<b>4</b>	<b>The Contractual Relationship Between Creditor and Debtor</b> .....	40
4.1	Preliminaries .....	40
4.2	The Mortgage as a Document Signed by the Mortgagor Only .....	41
4.3	Are There Specific Requirements for the Mortgage Deed? .....	41
4.4	Different Types of Mortgages .....	42
4.5	Identification of Security Object .....	43
4.5.1	The ship and her appurtenances .....	43
4.5.2	Can part of a ship be a security object? .....	44
4.5.3	Security in substitutes for the mortgaged ship: Insurance and damage claims .....	45
4.5.4	Security consisting of several independent objects (fleet mortgage) .....	45
4.6	Identification of Claim(s) Secured .....	46
4.6.1	One or more monetary claims .....	46
4.6.2	Contingent claims .....	47
4.6.3	The maximum amount requirement .....	48
4.7	The Effects of the Mortgage- Prior to Demanding Foreclosure .....	48
<b>5</b>	<b>Legal Protection of the Rights Flowing from the Mortgage</b> .....	50
5.1	The Concept of Protection .....	50
5.2	Registration of the Mortgage - Conditions and Procedure .....	51
5.2.1	The register .....	51
5.2.2	The mortgage document .....	51
5.2.3	Procedure .....	52
5.3	Effects of Registration .....	52
5.4	Amending the Mortgage Relationship by Later Agreement: Modifying the Secured Claim and Securing Further Claims .....	54
5.4.1	Amendments of the originally secured claim .....	54
5.4.2	Can the mortgage secure other claims than the original one? .....	55
<b>6</b>	<b>The Effects of Mortgaging - When Underlying Claim is not Paid</b> .....	58

## 1 The Topics to be Discussed

Participating in shipping on the shipowning side is capital demanding. First of all, buying a vessel is a huge undertaking. Also acquiring disposition over a vessel as a charterer may involve considerable sums.

Picked at random from the shipping gazette TradeWinds from 24th October 2003: Acquisition of bulkships: 73.000 tons built in 1995, purchase price USD 21,5 mill.; 69.000 tons built in 1995, 15,2 mill.; 149.000 tons built 1993, USD 28,5 mill.

Examples of timecharter rates for bulkers: 61.000 tons built 1984, USD 15.250 per day; 63.000 tons built 1984, USD 13.000 per day; 74.000 tons built 1999, USD 23.000 per day.

But also after having acquired tonnage – as owner or charterer – the capital demands are noteworthy. In addition to servicing the investment (or the time charter hire, as the case may be), there are the running expenses: wages to master and crew, maintenance of the vessel, insurance premiums, bunkers, harbour dues and expenses etc. And there is always the risk, greater than in many other commercial areas, that the unexpected or irregular incidents may occur, which may cost money. A grounding of the vessel or the involvement in a collision may cause delay and consequently loss of income, but first of all, expenses which have to be covered immediately, e.g. payment of collision liability, a salvage award, or a repair yard bill. In other words, it is necessary to have a working capital with built-in reserves for contingencies of the indicated types.

The shipowning entity – in most cases a company with limited liability – may have a sufficient equity to meet these requirements. But this is rarely the case, and we can safely state that owning and operating ships is dependent upon credit from one or more sources. Broadly speaking, there are these groups of persons or entities who may be sources of credit:

(1) As regards the acquisition of vessels:

- the shipbuilder in respect of new vessels, or the seller in respect of second hand vessels, or
- a third party willing to supply credit. In practice this means a bank or a similar finance institution. For the sake of simplicity we shall here talk of the credit supplying bank.

(2) As regards the current, daily operating expenses, some suppliers may be willing to grant credit, e.g. the supplier of bunker oil or of victuals to the ship. Another example is the repair yard extending credit for the repair bill. But generally speaking, if such credit is given, it is a short time credit, and in the majority of cases the supplier or the yard will require cash settlement on delivery (or security). This means that the credit has to be found in other quarters, and the practical solution is obtaining a credit line – a draft facility – in a bank, which can be used to cover all types of running expenses. Such a facility will often

presuppose an obligation on the shipowner to channel his income (first of all: freights) to the bank or even to the credit line account. In this way there may be automatic set-offs: Incoming freight will reduce the amount owing under the facility; which means that sometimes the balance may be positive seen from the shipowner's point of view.

(3) In extraordinary situations – typically: substantial liability arises because of collision, salvage or costly repairs – the creditor will demand satisfaction as soon as possible. And the shipowner who has not sufficient cash to meet the contingency, will have to rely upon credit from other sources. Also here the banks are important, but now there is another important third party that may come to the assistance of the shipowner, viz. the insurers. The insurance company (or an insurance association) is not, however, be suppliers of credit in the same way as the banks: The insurance company will pay the amount in question, usually without recourse to the shipowner.

Summing up: The shipowner has a need for credit, typically

- a *long term* credit when acquiring a vessel, or when a vessel shall undergo substantial repairs or modifications, and
- a *short time* credit to cover running expenses and minor contingencies.

And the banks are the obvious sources for both types of credit.

Ordinarily, the credit supplying bank will not feel comfortable without some form for security. The assets of the shipowning company may be substantial today and the incoming flow of freights may appear impressive and sufficient to service the credit lines, but experience has shown, over and over again, that the financial situation of a shipowning company may change dramatically over a short period. Thence, there is a demand for special security – in the meaning: a preferential right to seek satisfaction from identified assets.

The assets which a shipowning company may offer as security, may conveniently be categorized in this way:

- land based assets: real property, shares, bank accounts,
- assets directly connected with the shipping activity: the vessel and the freights which she is earning, as well as other vessels and their earnings.

Here we shall focus the vessel as security. It should, however, be had in mind that very often the security for a credit line will consist of “a package” of securities: The bank has, in addition to security in the vessel, security in freights and what here is called “land based assets”.

The purpose of this article is to examine some of the questions related to “a ship as security” when the applicable law is Norwegian law. A ship may, of course, serve as security for non-shipping credits, e.g. when the shipowning company is going to make investments in real property. The basic rules are the same, regardless of the type of credit secured, but in this article we shall, nevertheless, first of all have in mind shipping related debts.

The fundamental condition for the indicated use of the vessel as a security is that the shipowner retains possession and use of the vessel: It is through the operation of the vessel that he shall earn money, enabling him to pay interest and instalments.

The questions which it is natural to discuss in this context fall into several groups. First, the concept of security requires a description and an indication of the legal rules applicable where the security is a vessel (2 below). There are a number of risks connected with such a security: Some are of a factual nature, and a short discussion of these follows (3 below) before the contractual relationship between creditor and debtor is investigated (4 below). A security, as a preferential means of obtaining satisfaction, raises a number of issues as against third parties: To what extent must a third party – having competing interests based upon contract (typically: with a contractual security in the ship), or being a creditor (including the bankruptcy estate) – respect the security? (5 below). Finally the rules on actually using the security – the rules on enforcement – should be outlined (6 below).

A ship may serve as security not only based upon contract. The ship may be security in conformity with the rules on enforcement of claims: When debt is not paid when due, the Court or the enforcement officer can declare that e.g. a ship belonging to the debtor is security for the debt (an enforcement lien is created). Another possibility is that the law declares that creditors with specified types of claims, related to the activity of the ship, automatically have security in the ship (maritime liens), e.g. the seaman's claim for wages and the tort claim of the run-down vessel. These two types of security will only be briefly mentioned in some places, as security based upon contract is the primary concern.

## 2 The Security Concept, in Particular in Respect of the Mortgage – and the Legal Framework

Among the many types of security there is a fundamental distinction as to whether the secured creditor has the right, if necessary, to obtain payment by way of a forced sale. This article deals with securities entailing such a right.<sup>1</sup>

The Norwegian terminology in this area of law is difficult to translate: All types of security giving a right to forced sale – i.e. created by contract, by the decree of the enforcement authority, or directly by law – are called *pant*. And furthermore, this term is used regardless of the type of security object (real property, movables, monetary claims etc.). I shall use the term *lien* as an equivalent to *pant*. But in order to distinguish between the three mentioned types of liens I shall use the term *mortgage* for the contractual lien, *enforcement lien* for the second type, and *maritime lien* for the third one.

The mortgage is conceptually an *encumbrance* on the asset, like e.g. a right of preemption. Thus, the mortgage is *not a provisional transfer of property*. The

---

<sup>1</sup> As examples of the other category: The ship repair yard has a right of retention when the bill is not paid, but no right to sell the vessel, *see* the Maritime Code of 24<sup>th</sup> June 1994 no. 39 Sect. 54. Another example is the right obtained by an arrest decree; *see* Code of Enforcement of Claims of 26<sup>th</sup> June 1992 no. 86 Chap. 14.

owner mortgaging his vessel is at all times the equitable owner with all rights to dispose over the ship – legally and factually – in so far as his rights have not been restricted or limited by the obligations flowing from mortgaging the vessel (see 4 below). Transfer of ownership (title) is a consequence of a forced sale (see 6). This applies to the other types of liens as well: Neither the enforcement lien, nor the maritime lien affects the title (ownership); they are encumbrances on the asset in question.

The statutory rules on security are first of all found in:

- the Mortgage and Liens Act of 8th February 1980 no. 2 (MA),<sup>2</sup> and
- the Code of Enforcement of Claims of 26th June 1992 no. 86 (CoE).<sup>3</sup>

These rules are, as regards ships, supplemented by the Maritime Code of 24th June 1994 no. 39 (MC).<sup>4</sup> This act has rules also on registration of mortgages (and other encumbrances as well as ownership) whereby protection against third parties is obtained. These rules are basically the same as those applicable to real property.<sup>5</sup>

The value of a mortgage is often brought to test when the debtor is declared bankrupt. Thence, the legislation on bankruptcy may also be of importance, viz.

- the Act on Debt Settlement and Bankruptcy of 8th June 1985 no. 58 (Bankruptcy Act), and
- the Creditors' Seizure Act of 8th June 1984 no. 59 (Seizure Act).

### 3 Some Factual Risks Involved in Having a Ship as Security

The *value* of the liened asset, and, usually closely related thereto: the earning potential, are, of course, of paramount importance. Thus, the bank considering to grant a credit against security in a ship has to evaluate the ship as of today, but also its probable value during the credit period and a possible enforcement phase. Today's value may be ascertained with reasonable certainty by estimates from one or more experienced shipbrokers. The brokers may also give indications as to how the market will develop, but a realistic prognosis is

<sup>2</sup> See the adress "<http://www.ub.uio.no/ubit/ulov/sok.cgi>" for an unofficial, not fully updated translation. Generally, this text is used in quotations in this article. On this act in general, see Brækhus, *Omsetning og kreditt 2 Pant og annen realsikkerhet* [Liens and other proprietary security] (2<sup>nd</sup> ed 1994) and Skoghøy, *Panteloven* [The Mortgage Act] (2<sup>nd</sup> ed. 2003).

<sup>3</sup> Generally on this code, see Falkanger, Flock & Waaler, *Tvangsfullbyrdelsesloven* [The Code on Enforcement of Claims] (3<sup>rd</sup> ed. 2002).

<sup>4</sup> See the adress "<http://www.uio.no/~erikro/WWW/NMC.pdf>" for an unofficial translation; the text, which is printed in MarLus no. 236 (1997), is used in this article. On this code, see Falkanger & Bull, *Innføring i sjørett* [Introduction to maritime Law] 6<sup>th</sup> ed. 2004), in particular Chap. 6 on liens (in nthe borad sense of this word); see also the English version: Falkanger, Bull & Brautaset, *Introduction to Maritime Law* (1998).

<sup>5</sup> See the Property Rights Registration Act of 7th June 1935 no. 2.

difficult, because shipping values are very volatile – the prices depend upon a number of factors which are very difficult to predict.

In addition to market factors relevant for the value of the ship and the freight market, mention should be made of some factors which may directly influence the individual asset. We have “internal” factors: A ship which is not properly run and maintained may lose its value dramatically during a short period. Not only the balance value of the ship may be affected, but also the earning capability of the ship may deteriorate by poor management: valuable contracts may be lost, the vessel may have extensive off hire periods, etc. The creditor can, however, to some extent protect himself against this type of risk, see 4.7 below.

External factors are e.g. bad weather or collisions which may lead to total loss of the vessel or prolonged repair periods. Such serious threats to the creditor may be lessened by adequate insurances on the ship and the freight. In short, a hull insurance will protect the creditor’s interests in several ways: First, if the vessel is lost and a compensation from the insurer is due, then the creditor with a mortgage on the vessel is entitled to his share of the amount.<sup>6</sup> Secondly, if the vessel suffers damages, e.g. due to a collision or grounding, the value of the vessel and its freight earning capability will be regained after repairs, for which the insurer will pay. The liability insurance (the P & I-insurance) is also important: Claims against the shipowner will not drain the working capital of the shipowner, which might result in difficulties in repaying the mortgage creditor. A further consequence is that when claims are being paid by the liability insurer, possible maritime liens securing the claim are extinguished. A third type of insurance, indirectly protecting the interests of the mortgage creditor, is the loss of hire insurance. If the vessel suffers damages, in principle recoverable under the hull insurance, then the loss of hire insurer will pay a compensation for lost income during the repair period.

## **4 The Contractual Relationship Between Creditor and Debtor**

### **4.1 Preliminaries**

In principle, one should distinguish clearly between rules applicable as between the parties, and rules on protection against third parties, including the creditors of the mortgagor. The border line between the two is sometimes difficult to draw, but from a practical point of view it is not necessary to investigate its niceties - because a non-protected mortgage – which as we shall see means a non-registered mortgage – must be considered as a working accident. The pragmatic approach here is that the registration questions are dealt with in 5, both the more formal rules on registration as well as the substantive rules on the effects of registration. However, the requirement that the mortgage deed shall state a maximum amount for the claim secured is considered in connection with the description of the validity rules.

---

<sup>6</sup> See 4.5.3. below.

#### 4.2 *The Mortgage as a Document Signed by the Mortgagor Only*

Posting security may be a unilateral act; e.g., the debtor provides security in respect of already existing debts – perhaps after considerable pressure from the creditor. Usually, however, a mortgage is an element in a reciprocal contractual relationship: Credit is granted on the condition that security is provided. Also here the mortgage document will appear as an isolated contractual undertaking, i.e., the document will be signed only by the mortgagor. But the obligation to issue and sign the document will ordinarily follow from a reciprocal credit agreement.

It is important to note that also the truly unilateral mortgage declaration is binding, which is in conformity with the basic Norwegian contractual concept that a unilateral promise is binding<sup>7</sup> without special formalities (like “consideration” or “under seal”).

#### 4.3 *Are There Specific Requirements for the Mortgage Deed?*

The mortgage deed has, at least, to comply with the general rules on when promises are binding. But as mortgaging may have far reaching consequences, often not fully understood by the mortgagor at the time of mortgaging his vessel, it might be expected that the ordinary rules on binding contracts are not sufficient. Generally speaking, this is not the case. Three issues deserve, however, special consideration.

First, a minimum requirement might be that the transaction is *documented*, but the law does not demand so. However, in order to have the mortgage registered, writing is, of course, necessary. From a practical point of view writing is, therefore, a rule without exception. Furthermore, it should be noted that registration to some extent requires that the mortgage document is formatted (see below 5.2.2).

Secondly, MA Sect. 1-3 (2) provides that when a right cannot be assigned, or can be assigned only on certain conditions, the same limitation applies in the matter of attaching a mortgage. In respect of ships such restrictions on assignment may in practice follow from a previously registered encumbrance on the ship, e.g. a mortgage wherein it is stipulated that further mortgages on the ship are not allowed, or that further mortgaging of the ship is subject to approval from the first mortgagee.

Thirdly, a vital question is often: Who is entitled to mortgage an asset - in our context: a ship - belonging to a company? The answer depends upon the nature of the company.

A ship owned by *part owners*<sup>8</sup> can be mortgaged by a decision of the partner(s) owning more than a half interest in the partnership (MC Sect. 108).

<sup>7</sup> There is, of course, a requirement that the promisor has the intention to create a legal obligation or that he has expressed himself (or behaved) in such a manner that the promisee had reasonable grounds for inferring such an intention.

<sup>8</sup> MC Sect. 101 has this definition: “A shipping partnership shall mean a firm having for its purpose the business of a shipowner, where the partners have unlimited liability in respect of the firm’s obligations, either jointly and severally, or in proportion to their holdings in the firm.”

The general authority of the managing owner does not comprise mortgaging, but he may be entitled do so on the basis of “special authority” (MC Sect. 104).

A *general partnership* will in most instances have a board of directors, which is responsible for the management of the company’s affairs, including decisions on mortgaging (Act on Unlimited Partnerships and Limited Partnerships of 21st June 1985 no. 83 Sect. 2-13). The company meeting (i.e. a meeting for all partners) may appoint a chief executive officer (CEO), who shall follow the directives and orders given by the company meeting or the board. His authority does not comprise “matters which depending upon the situation of the company are of an unusual nature or of great importance” (Sect. 2-18). This means that whether a CEO is entitled to mortgage the company’s ship cannot be answered with a simple yes or no. For *the limited partnership* the Act says expressly that mortgaging, as the main rule, is a matter for the company meeting (Sect. 3-6). The general partner can only mortgage when awaiting the decision of the company meeting would cause substantial disadvantages (Sect. 3-9). The appointed CEO acts fully under the instructions of the company meeting, the board and the general manager (Sect. 3-11).

There are two types of *companies limited by shares* - the private limited company (ltd.) and the public limited company (plc.), see Acts of 13th June 1997 nos. 44 and 45. For both types the board is, of course, competent to mortgage. Whether the CEO has authority to mortgage depends upon the same formula as mentioned for the unlimited partnership (both Acts Sects. 6-12 and 6-14). But in addition we meet another principle (both Acts Sect. 6-33): The company is bound even if the CEO has acted outside his authority, unless it is substantiated that the third party knew or ought to have known of this lack of competence and it would be against honesty and good faith to rely upon the disposition.

#### 4.4 *Different Types of Mortgages*

Traditionally, there has been a distinction in Norwegian mortgage law between two types of mortgage documents:

- (i) the effective mortgage document (Norw.: “reell pantobligasjon”) and
- (ii) the accommodation mortgage document (Norw.: “akkomodasjonsobligasjon” or “gjort (pant)obligasjon”).<sup>9</sup>

The former reflects the true nature of the relationship: It spells out the amount owing, the amortization schedule and the rate of interest as well as payment dates - and, of course, that these obligations are secured by a mortgage. The accommodation mortgage may formally appear as an effective mortgage

---

<sup>9</sup> There is also a third type of mortgage document, wherein it is expressly stated that the security is for possible future claims, e.g. the liability which a contractor may incur under a building contract (Norw.: “skadesløsbrev”). Finally, security may be established without the use of a typical mortgage document, usually in this way: When transferring real property or a ship, the deed of title may contain a reservation: For the unpaid part of the purchase price the seller shall have the property as security.



document, but the real (the “effective”) relationship between the parties is different and will, typically, be found in a loan contract. One cannot say that the accommodation mortgage is merely a pro forma document, because it is undoubtedly the intention of the parties to create a security, and this intention appearing from the document is legally accepted by the courts.

The distinction between the two document types may appear as irrational, and has from time to time been heatedly debated. This is not the place to investigate the historical reasons for the distinction, nor the arguments which may be presented in respect of the advantages and disadvantages flowing from a review of the situation today. Here it must suffice to state that today an effective mortgage document is a rare exception in the commercial sector. The complexity of the financial arrangements and on the other hand the requirement that the document presented for registration should be simple, encourage the use of accommodation mortgages. Thus, we shall in the following assume that the mortgage document is essential in respect of creating a security, but does not give true information on the underlying obligations of the mortgagor. For that we have to go to the loan agreement, a document which is getting increasingly more complex.

## **4.5 Identification of Security Object**

### **4.5.1 The ship and her appurtenances**

The security object is in our case a ship,<sup>10</sup> which has, of course, to be properly identified. In the Norwegian standard Ship Mortgage Deed<sup>11</sup> this is achieved by the use of the name of the ship, its signal letters, the register wherein the ship is entered, building year and home port.

Identifying the ship is not sufficient in all respects; one has also to decide to what extent appurtenances are included. The precise delimitation depends in principle on the mandatory rules in MC Sect. 45, the main rule being:

Mortgages and other encumbrances upon any ship which has been or can be entered in the Register of Ships, cf. Section 11, shall also attach to each separate part of the ship, and to anything belonging to the ship which is on board or has been temporarily removed. No separate right can be established to such parts or appurtenances. Provisions, fuel and other consumable stores shall be deemed not to be such appurtenances.

The only exception worth mentioning in the present context is that the main rule does not apply to appurtenances belonging to a third party when they have been

---

<sup>10</sup> On several ships being the security object, *see* below 4.5.4.

<sup>11</sup> This standard (Bl.nr. E25.052.11. Copyright SPAMA) - consisting of four pages - has been prepared by the Norwegian banks. On the first page the parties and the ship are identified, there is an acknowledgement of debt and a declaration of mortgaging the ship, as well as a clause restricting sale or further encumbering without the consent of the mortgagee. The second page contains “Conditions” (which are to some extent commented upon below in 5.2). The third page is for the signature of the debtor and for confirmation of his signature.

“hired by the shipowner on a contract which the shipowner can terminate at no more than six months’ notice”. Thus, equipment acquired on a hire purchase basis (e.g. life boats and other life saving equipment) becomes part of the security as soon as the equipment is brought on board the ship, and the proprietary right of the seller is at the same time extinguished. On the other hand, equipment hired on a short time basis (e.g. electronic navigational equipment) may be subject to special rights which the mortgagee has to respect. The position is similar with regard to equipment on board belonging to the time charterer (e.g. equipment for loading/discharging and securing the cargo).

The MA Sect. 1-6 stipulates that in “case of non-possessory liens the owner has the right to the yields from the attached property”. Thus, a mortgage on the ship does not comprise the freights earned by the ship. It is, however, possible to have these as a security according to Sect. 4-4, provided they are “on a named debtor” or “will arise against a named debtor in a specifically mentioned situation” (e.g., the charterer under an identified time charterparty). Protection is here obtained by notification to the debtor (e.g., the time charterer).

#### **4.5.2 Can part of a ship be a security object?**

It follows from a general principle of mortgage law that the owner of a ship cannot mortgage e.g. 60% of his interest; the mortgage has to comprise the mortgagor’s total interest in the security object.<sup>12</sup> A part owner mortgaging his part in the vessel does not conflict herewith, but there are other considerations which may preclude such a disposition. The general or the limited partnership is considered to be a joint undertaking where it is not accepted that a partner mortgages a part of the ship, i.e., a part corresponding to his part in the partnership. Here, the security object must be his interests in the partnership. It was argued for a similar solution for part owners when the pertinent chapter in the maritime code was revised in the 1970-ies, but objections from the shipping industry led to a compromise: A part owner may mortgage “his part” of the vessel, provided that the co-owners agree (MC Sect. 113), in which case his creditors become entitled to seize such part.<sup>13</sup> However, this possibility is seldom used, because of the exposed position of a mortgage limited to a part of the ship when the (total) ship previously has been mortgaged.<sup>14</sup>

---

<sup>12</sup> See the MA Sect. 1-3 subsect. 3 and Sect. 2-1 subsect. 2.

<sup>13</sup> See *Innstilling VIII fra Sjølovkomiteen* [Report no. VIII from the Maritime Law Commission to the Ministry of Justice] (1966) pp. 70-71.

<sup>14</sup> When trying to have the part sold at a forced sale, this cannot be carried through unless the purchase price is sufficient to cover all encumbrances with better priority (CoE Sect. 11-20); the problem is that - presumably - the previous mortgage has to be taken into account with its full amount, not only with a portion corresponding to the part which is subject to the forced sale, *see* the discussion in Falkanger, Flock & Waaler op. cit. pp. 710-712.

### 4.5.3 Security in substitutes for the mortgaged ship: Insurance and damage claims

There are two forms of substitutes for the mortgaged vessel which are of practical interest for the mortgagee.<sup>15</sup>

First, we have the question of to what extent the mortgagee will benefit from insurances on the vessel. Most important is the hull insurance, entitling the shipowner to compensation when the ship is totally lost and to have the repair costs covered when the ship is damaged. Under the Norwegian Marine Insurance Plan of 1996 Chap. 7 the mortgagee is automatically co-insured, i.e., no special agreement or declaration is required, but he is covered only to the same extent as the owner.<sup>16</sup> In case of a total loss of the ship, the interest of the mortgagee shall be covered first. Therefore, it is important that the insurer has knowledge of the mortgaging.

When the ship is damaged the insurer will pay the repair costs, thus the value of the security is reinstated. The mortgagee's interest is here protected by the rule that payment by the insurer to the owner is subject to presentation of a "receipted invoice for repairs carried out".

Insurances may also, as indicated above, give the mortgagee other indirect benefits, e.g. when the P&I-insurer pays, the maritime lien threatening the mortgage is eliminated.

Secondly, if the ship is damaged by a third party the mortgagee may have an independent claim. This is, e.g., the situation when the third party is responsible for negligent navigation leading to collision damage on the mortgaged ship.<sup>17</sup>

### 4.5.4 Security consisting of several independent objects (fleet mortgage)

Depending upon the circumstances, the creditor may consider the ship as insufficient security for his claim, the outcome being that he obtains security in two or more separate objects. Practical examples are: The claim is secured by a mortgage on two ships or perhaps all ships owned by the debtor (a fleet mortgage), or the security is the ship and the freights earned by the ship.<sup>18</sup>

The position of the creditor having security in more than one object is regulated by MA Sect. 1-12. In the absence of a special agreement the creditor

---

<sup>15</sup> Generally on the mortgagee's right to substitutes for the security object, *see* Brækhus *op. cit.* pp. 191-194.

<sup>16</sup> The Insurance Contract Act of 16th June 1989 no. 69 gives the mortgagee a better protection, *see* Sect. 7-1 and Sect. 7-3; but the rules are not mandatory in marine insurance, *see* Sect. 1-2 subsect. 2 letter c (and also Sect. 7-1 subsect. 4).

<sup>17</sup> To this section 4.5.3, *see* MC Sect. 72, directly stating that the holder of a maritime lien does not derive advantages from insurance on the ship or from the owner's tort claims against third parties. The necessity of stating this rule is to make clear, that the general principles on the position of the mortgage, and to some extent the enforcement lien, do not apply to the maritime lien.

<sup>18</sup> The questions relating to security in freights are outside the scope of this article. It is, however, mentioned in 4.5.1 above that MASect. 4-4 allows using outstanding freights as security.

may, in default situations, decide which of the objects he will seek satisfaction from first. Such a freedom may create difficult distribution problems when the objects are encumbered differently. In order to eliminate the consequences of the creditor's choice of order of foreclosure, the Act has a set of secondary settlement rules of a proprietary nature.<sup>19</sup>

The fleet mortgage presents an additional question: Is it possible to mortgage "all ships owned by A" as a *universitas rerum* - with (i.a.) the consequence that when A acquires a new vessel it becomes automatically part of the security? The law accepts the *universitas rerum*-principle in a number of cases, but not in respect of ships. Thus MC Sect. 42 clearly says that the mortgage agreement must "individualize the security object". But as regards the appurtenances to a ship we have an element of *universitas rerum*: The security comprises the appurtenances existing as they are at any time; e.g., the mortgage comprises new equipment when it is brought on board the ship, and, conversely, the discarded equipment brought ashore is no longer part of the security (but the item temporarily brought ashore, e.g. a navigational instrument needing repairs, is still part of the security).

## 4.6 Identification of Claim(s) Secured

### 4.6.1 One or more monetary claims

The claim, whether existing at the time of mortgaging or being a future one, must be a monetary claim, but it may very well derive from a non-monetary claim - the typical example being damages for breach of contract. The security may apply to more than one claim, e.g. the ship is security for a long term bank loan as well as for possible recourse claims in respect of guarantees given by the bank.

In principle the claim may be in any kind of currency.<sup>20</sup>

What are then the requirements for identifying the secured claim?

The law requires that at least a maximum is stated for the claim(s) secured (see 4.6.3). Otherwise the rules are very simple:

<sup>19</sup> E.g., A has a claim for 200, secured by a first priority mortgage on x and a first priority mortgage on y, while B's claim amounting to 100 is secured by a secondary mortgage on x. If A decides to have x sold first, B may lose his security; if y is sold first, this may give full payment to A, and B's security in x is satisfactory. This gives the background for Sect. 1-12 subsect. 2 providing, with a view to the example: If A has obtained satisfaction from x for a larger part of his claim than should fall on x in accordance with the legal relations between the parties, B may for the excess part enter into the mortgage on ship y. Assuming that the relations between the parties indicate an equal distribution of A's claim on x and y, and that A gets 150 from the sale of x, the consequence is that B enters into A's mortgage in y in respect of 50, of course with priority after the remainder of A's claim, which is 50.

<sup>20</sup> The general rule in the MA Sect. 1-4 subsect. 2 is that the claim shall be specified in NOK "or in foreign money for which a stock exchange rate is normally quoted in Norway" - the basic idea being that e.g. a mortgagee with second priority shall be able to calculate, without too much difficulty, what his own exposure is. But MC Sect. 42 has a special rule for ships, permitting specification in "Norwegian or foreign currency".

Whether the security applies to one or more claims, ordinarily the mortgage document will not identify the claim(s), e.g., by stating the occasion for its (their) existence and the date when it (they) arose. The document will express only that the mortgagor owes a specified amount to the creditor; why it is so has to be ascertained from the underlying relationship (e.g. a loan agreement).

The parties may agree when the mortgage is created that the mortgage shall be security for future claims, if any. And if the mortgage originally secured one defined claim, it may later on be agreed that the mortgage shall cover additional claims. Such agreements are of particular interest to the other mortgagees, and the theme is more conveniently discussed below in 5.4.

#### 4.6.2 Contingent claims

In addition to the principal claim the creditor will usually have a claim for interest and sometimes other contingent claims (e.g. insurance premium, see below).

Payment of interest is regularly agreed, and when the principal is secured the agreement will in most instances include a provision that the security applies to interest as well. To a wide extent this follows also from the law; MA Sect. 1-5 letter b presumes that interest is secured in the same way as the principal,<sup>21</sup> however, with a time limitation. The interest must be (i) earned later than two years before a mortgagee demanded forced sale (or forced use) of the vessel,<sup>22</sup> provided that the sale (the forced use) is carried through, or (ii) earned later than two years before opening proceedings of public composition or bankruptcy.

As indicated, insurance is usually a condition for the credit arrangement. In order to protect his position the mortgagee may consider it necessary to pay the insurance premium if the mortgagor fails to do so. It is natural for the mortgagee to stipulate that the recourse claim shall be secured. Also in this respect the Mortgage Act Sect. 1-5 has (in letter d) a presumption in favour of the mortgagee: The security applies to “premium for fire insurance and other customary property insurance for the period later than one year before the events mentioned in letter b, when the mortgagee has paid the premium for the owner”.

The standard Ship Mortgage Deed covers interest and insurance premium and also other types of claims, saying that the security applies to:

“Principal, interest and charges etc. and costs incurred to safeguard the mortgaged ship and other costs to safeguard the security and all other claims which may arise from the loan under the following conditions.”<sup>23</sup>

---

<sup>21</sup> If the security is not sufficient to cover both principal and interest, the interest shall be covered first - which may be of importance when deciding later on whether the creditor's claim is subject to time prescription. *See* Code of Enforcement of 1915 Sect. 168 subsect. 2; presumably, this is still the rule.

<sup>22</sup> E.g., a demand for forced sale is submitted to the court 1st June 2004. Here unpaid interest related to the time after 1<sup>st</sup> June 2002 is secured together with the principal amount.

<sup>23</sup> As for these conditions, *see* 4.7 below.

### **4.6.3 The maximum amount requirement**

The requirement that a maximum should be stated for the sum which the creditor can obtain from the security, follows from the MA Sect. 1-4 subsect. 1:

“A lien [including, primarily, a mortgage] obtains protection [against third parties] only when a fixed amount or a maximum amount for the secured claim is stipulated, unless otherwise provided in this Act. However, this does not prevent protection for the additional claims mentioned in Sect. 1-5.”

Practically speaking this means:

When an accommodation mortgage document is used, the document will show that the ship is security for a fixed amount. This is not necessarily the real debt; the figure in the document serves as “a maximum amount”. The importance of the exception in the second sentence in the quotation is that, e.g., interest may be covered even if this claim comes in addition to the stipulated amount, provided, however, that the interest is secured in accordance with Sect. 1-5 (see 4.6.2).

E.g., the principal, say 100, equals the amount stated in the document. As interest has not been paid for a long period, the mortgagee demands a forced sale on 1st June 2004, and such a sale is confirmed by the Court on 1st of December - with “settlement day” (see CoE Sect. 11-36, cf. Sect. 11-27; “settlement day” is explained below in 6) say on 1st February 2005. Here the mortgagee will have security for interest earned as from 1st of June 2002 (two years before forced sale was demanded) and up to settlement day 1st February 2005. With say 10% interest this means that the total take of the mortgagee may be 125. Or from another point of view: The lender who is offered a second priority mortgage has to take into consideration that he may not get anything out of the security before the first priority mortgagee has got a sum which may be substantially higher than the fixed amount or the maximum given in the mortgage document.

Also the premiums mentioned in 4.6.2 and the costs of enforcing the mortgage claim have a similar privileged position.

### **4.7 *The Effects of the Mortgage – Prior to Demanding Foreclosure***

The most important effect of mortgaging a vessel is, of course, the creditor’s right to demand a forced sale (see 6 below). But mortgaging has effects prior thereto: The creditor’s main concern is that the value of the security is protected, but putting too heavy restrictions on the debtor may hamper the debtor’s possibilities of earning the money necessary for servicing i.a. the debt. And it should also be remembered that giving one mortgagee a decisive saying regarding the use of the vessel, may appear unfortunate in view of other interests in the vessel.

MA Chap. 1 has some rules of a general nature on the effects of a mortgage, being, however, as a starting point, of a non-mandatory nature, these rules can be dealt with briefly.

Sect. 1-6 states that in the case of non-possessory liens – whereof the ship mortgage is one example – “the owner has the right to the yield from the attached property”. In other words: The shipowner is entitled to the freights earned, unless there is an agreement to the contrary.<sup>24</sup>

Most important, it follows from Sect. 1-7 that the owner has the right to use the ship “in the usual manner except as otherwise provided by agreement, distraint provisions or other statutory rules”. He is, however, responsible for “the proper care and maintenance” of the ship, so that the security of the mortgagee is not reduced. Furthermore, the mortgagor is “obliged to maintain fire and other property damage insurance to the customary extent”.

Sect. 1-9 has rules on when the debt falls due, in the ordinary way as well as for extraordinary reasons (e.g. non-payment of interest, abuse of the vessel, severe damage to the vessel). A corresponding provision is MC Sect. 44.<sup>25</sup>

As regards legal disposition of the vessel, the main rule in Sect. 1-11 is that the owner may sell the mortgaged ship; this does not free the owner from his personal liability as against the creditor. In most cases this problem does not arise as the vessel is sold “free of encumbrances”.<sup>26</sup> But if that is not so, it is usually agreed between seller and buyer that the buyer shall service the debt, and this promise on the part of the buyer is considered also as a promise directed to the mortgagee. If the mortgagee accepts this third party promise – explicitly or implicitly – the consequence is that the seller is relieved of his liability.<sup>27</sup> The mortgagor may not only sell the vessel; he is also entitled to create special rights in the vessel, e.g. giving A a right of preemption or B a security (a mortgage= in the vessel).

Chap.1 has also some rules on the mortgagee’s possibilities to dispose of his rights flowing from the mortgage. The main rule in Sect-1-10 is that he may transfer his rights (“sell the mortgage”) – typically: debtor A’s engagement with bank B is transferred to bank C. But the mortgagee may also use the mortgage for security purposes: B’s obligations towards C are secured by a lien on B’s rights under the mortgage issued by A (Norw.: “frempansettelse”).

In professional relationships where there may be substantial risk elements, the mortgagee will not be satisfied with the general rules in the Mortgage Act. He will require a more strict control with the activities of the shipowner. This may be illustrated by referring to the conditions in the standard Ship Mortgage Deed. As they cover one printed page it is necessary to make excerpts:

Sale or further mortgaging of the ship is subject to consent from the mortgagee. So is a charterparty for more than 12 continuous months, or a bare

<sup>24</sup> On security in freights, *see* 4.5.1 *in fine*.

<sup>25</sup> This section, dating back to an enactment of 1972, became superfluous when we got the general provision in MA Sect. 1-9, but it was retained with a view to international relations: It was considered practical to have some of the basic mortgage rules in MC.

<sup>26</sup> This means that the seller has to agree with the creditor that the debt shall be paid now, and consequently that the creditor will accept deregistration of the mortgage.

<sup>27</sup> *See* MA Sect. 2-7 and Skoghøy *op. cit.* pp. 204-216.

boat charterparty regardless of duration. Measures to alter the ship's nature or involving major costs are also subject to approval. And the ship shall not be employed "in defiance" of law or "insurance terms which have been accepted by the creditor".

The insurance coverage which the debtor is obliged to have, is defined. He "undertakes to take out such insurances as required at any time by the creditor", and the insurance terms etc. are subject to the approval of the creditor. If the debtor fails to fulfill his obligations, "the creditor has the right to cover the insurances for the debtor's account".

Furthermore, the debtor is obliged to give specified information to the creditor on the ship and its status as well as his own financial status. And the creditor has "at any time" the right to inspect the ship and have it revalued; if there is a substantial reduced value, the creditor is entitled to demand "extraordinary repayment of the debt".

However, these standard conditions in the standard mortgage document are usually of minor importance, because of the long, detailed loan agreements – inspired by the English-American tradition – which are regularly used for transactions of some importance. Here the matters dealt with in the standard mortgage document – and others in addition – are regulated very carefully, with definitions of the obligations of the parties, in particular the obligations of the debtor. And not least, there are detailed rules on the consequences of not complying with the terms of the agreement. Typically, breach on the part of the debtor will entitle the creditor to demand further security, to demand a down payment of the credit or even immediate payment of the total amount outstanding.

Such clauses entitling the creditor to declare default are subject to censure by the courts if they are more strict to the debtor than what follows from MA Sect.1-9. Originally this was stated in Sect. 1-9 subsect. 2 (as well as in MC Sect. 44), but the rule was deleted when we in 1983 got the general stipulation in the Contracts Act of 1918 Sect. 36 entitling the courts to set aside – wholly or partially a contractual clause which has effects which are unreasonable or is contrary to good commercial customs.

## **5 Legal Protection of the Rights Flowing from the Mortgage**

### ***5.1 The Concept of Protection***

As the purpose of the mortgage is to provide security for the creditor in case of default on the part of the debtor, protection against third parties is essential. And such protection – against competing mortgagees etc., as well as the creditors of the mortgagor – is obtained by registration of the mortgage in the ship register, cf. Maritime Code Sect. 41 subsect. 1:

"A voluntarily established mortgage on a ship can only obtain legal protection by registration of the right in accordance with the provisions of Chapter 2."



Here we shall briefly outline the requirements for registration before the main rules on the effects of registration are considered.

## **5.2 Registration of the Mortgage - Conditions and Procedure**

The basic condition for registration of a mortgage is that the ship is registered in the ship register. There are two registers in Norway, a traditional ship register (NOR), regulated by MC Chap. 2 (supplemented by Regulation no. 593 of 1992), and an international ship register (NIS) based upon an Act of 12<sup>th</sup> June 1987 no. 48. The former is for Norwegian owned<sup>28</sup> vessels, while the latter is open for registration of Norwegian as well as non-Norwegian vessels.<sup>29</sup> For the sake of simplicity we shall, however, limit this survey to ships in NOR.<sup>30</sup>

### **5.2.1 The register**

Here it is sufficient to state that the register, covering the total country, localized in Bergen, is based on ADP-technique, and that the registered information is accessible to the public in general. A ship qualifying as Norwegian is entered in the register upon notice from the owner (MC Sect. 12). The registration request shall contain information and be supplemented by documents as stipulated in MC Sect. 13.

### **5.2.2 The mortgage document**

Registration of a mortgage presupposes a written document, in Norwegian, Danish, Swedish or English, and it “must be so legible and clear that no doubt arises as to how it should be noted” (MC Sect. 15 subsect. 1). The Ministry can issue regulations relating to the form of the document, but so far this has been limited to a directive that if “the document contains information that cannot be registered, this should be gathered together separately at the end of the document” (Regulation no. 593 of 1992 Sect. 16).

The document has to be signed by a competent person (see 4.3 above), and the signature has to be verified, e.g. by an advocate or a notary public (MC Sect. 15 subsect. 2). In addition, the document has to be signed by the person/company registered as owner. Usually, the issuer of the mortgage (the debtor) is also the owner of the ship and is registered as such. But it is fully possible to be the debtor without being the registered owner; then also the signature of the registered owner is required, i.e. he has to assent to the

---

<sup>28</sup> The criteria for whether a vessel is Norwegian are spelt out in MC Chap. 1.

<sup>29</sup> There are certain operational benefits in being registered in NIS, but on the other hand, a vessel registered in NIS is excluded from certain trades, in particular carriage of passengers and/or goods between Norwegian ports.

<sup>30</sup> The rules for NIS are basically the same. It should be noted, however, that the NIS register - compared with MC Sect. 13 - should show some additional information on the owner and manager, depending upon the basis of registration, *see* NIS Act Sect. 1.

mortgaging (and his signature has to be verified). Whether he at the same time accepts personal liability for the debt depends upon the circumstances.

Furthermore, a condition for registration is that the document does not contain stipulations contrary to what previously has been registered. Thus, the registered stipulation in the standard Ship Mortgage Deed that the “mortgaged ship shall not be sold or further encumbered without the consent of the mortgagee”, prevents the registration of another mortgage (unless consent is obtained).

### 5.2.3 Procedure

The original mortgage document, together with a copy, is sent or delivered to the registrar. The fees for registration have to be paid before registration.<sup>31</sup>

The document is registered in the daily journal with a note of date and minute of receipt. If the document is found to be in order, it will be entered in the register.<sup>32</sup> The full text will not be written in, only an abstract of the contents of the document.<sup>33</sup> The original will be returned with a certification thereon by the registrar that it has been registered as well as the time of registration, and together with it will follow an extract of the register showing previous registrations which may affect the priority of the mortgage.<sup>34</sup>

Against the decisions of the registrar, accepting or refusing registration, there is a right of appeal to the Ministry of Trade and Commerce.

### 5.3 *Effects of Registration*

The effects of registration are stated in MC Sects. 23 to 27. Only the main rules will be described here.

Sect. 23 subjects. 1 and 2 state:

“Acquisitions of rights that are registered shall rank in priority before those that are not registered.

In the event of a conflict between registered acquisitions of rights, that which was first entered in the journal shall have priority.”

This means, e.g., that a mortgage signed in 2003, but not registered, will rank after a mortgage or a registered enforcement lien from 2004 which is registered the same year. Another example: A mortgage from 2003, registered in February 2004, will have priority after a mortgage signed and registered in January 2004,

---

<sup>31</sup> In 2004 the fee for registration of a mortgage – regardless of the amount secured – is NOK 1.850, both in NOR and NIS.

<sup>32</sup> With adp-technique this means that registration in the journal and the register takes place simultaneously, but with a note that the entry in the register is provisional. When the checking of the document is finalized the note will be removed if nothing prevents registration; if the opposite is the fact, the registration will be deleted.

<sup>33</sup> The full text will appear from the copy, which is retained by the registrar.

<sup>34</sup> To the above, *see* in particular MC Sects. 14 and 17.

or after an enforcement lien created and registered in January 2004. However, in respect of registered rights deriving from contract, there is an important exception in Sect. 24: An earlier right shall rank prior to a later registered one if the latter is voluntarily acquired and the acquiring party, at the time when his right was registered, “knew or ought to have known about the earlier right”.<sup>35</sup>

It should be added that two (or more) acquisitions may have the same register time – e.g., they come to the register with the same delivery of mail. Then the two rights have the same priority, with the exception that enforcement liens (and arrests) have prior rank, and among the enforcement liens registered at the same time, the time of enforcement is decisive (Sect. 23 subsect. 3).

When a seller of a ship gives the buyer credit – for the whole or part of the purchase price – it is natural to have security for correct payment in the form of a mortgage on the ship.<sup>36</sup> The general rules indicated above may e.g. lead to, that an enforcement lien on the vessel, levied at the request of one of the buyer’s creditors, rank prior to the seller’s mortgage. Sect. 24 subsect. 2 has rules making it possible to avoid this result. Here it is sufficient to quote the main rule in the first sentence:

“Upon a sale or other transfer of ownership, a right deriving from the previous owner and which appears in the document of title of the new owner, or is entered in the journal no later than at the same time as the document of title, shall rank prior to rights deriving from the new owner.”

The practical way of using this provision is that (i) the formal document evidencing transfer of title to the ship,<sup>37</sup> signed by the seller, and (ii) a mortgage for the remainder of the purchase price, signed by the buyer, are delivered for registration at the same time by the seller. Alternatively, the security may be reserved in the document of title.<sup>38</sup> Usually it is considered better to organize the debt in an ordinary mortgage document, signed by the debtor. The effect of this exception is that as long as the seller has not signed and delivered the transfer of title document he is protected against the dispositions of the buyer and enforcements on behalf of the buyer’s creditors.

In case of bankruptcy the rules are stricter: Now it is not a question of priority, but whether the mortgage will be respected by the bankruptcy estate. Sect. 25 provides that “a voluntarily established right” – which includes the mortgage – “must, in order to be protected against bankruptcy, have been

---

<sup>35</sup> Note that this exception does not work to the detriment of the creditor with an enforcement lien: If his lien is registered, he will have priority over the earlier non-registered mortgage (or enforcement lien) also where he at the time of the creation of the enforcement lien or later had full knowledge of the earlier right.

<sup>36</sup> Part of the background for this conflict is that the creditors are entitled to seize all property actually belonging to the debtor, *see* the Seizure Act Sect. 2-2. Thus the enforcement authorities may decide that the buyer of a ship is actually the owner even though the formal title has not been transferred.

<sup>37</sup> Normally this is a document which in Norwegian is called “skipsskjøte”.

<sup>38</sup> This may be along these lines: The title is hereby transferred, but with the reservation that the ship is security for the remainder of the purchase price NOK ..., which shall carry interest ...- and instalments be paid ...

entered in the register journal no later than the day before the commencement of such bankruptcy proceedings”.<sup>39</sup> There are a few exceptions. The only one to be mentioned here is that the rules in Sect. 24 subsect. 2, described above, are valid also against the bankruptcy estate. E.g., the seller may have given up possession to the buyer, but if the buyer has retained the formal title (transfer of title has not been registered), his claim for the remainder of the purchase price will be protected against the bankruptcy estate, i.e. he will get payment in full, not only dividend payment.

It follows from these rules in Sects. 23 to 27, as well as case law, that when a registered mortgage is deleted from the register because the debt is paid, then the mortgages with a lower priority will advance in the priority hierarchy.<sup>40</sup> In other words: Payment does not create “a free space” which the owner can dispose of, or his creditors can attach; the encumbrances with lower priority fill automatically the free space - unless there is a clear stipulation to the contrary.<sup>41</sup> The standard Ship Mortgage Deed – using the term “right of succession” for this right to a better priority position – is a typical example, stating *ex tunc*:

“This mortgage has right of succession as and when claims of equal or prior rank are paid off or redeemed.”

#### **5.4 Amending the Mortgage Relationship by Later Agreement: Modifying the Secured Claim and Securing Further Claims**

From time to time amending the original credit- and/or security arrangement may be desirable or necessary. As between the parties this involves questions of ordinary contractual relations or waivers of rights, but difficulties may arise in relation to third parties. Here we shall examine some of the basics: To what extent is the position of B, being a mortgagee or a holder of an enforcement lien on second priority, influenced by agreements between the debtor and the first priority mortgagee (A)?<sup>42</sup>

##### **5.4.1 Amendments of the originally secured claim**

A reduction of the down payment period for A’s mortgage will usually be to the benefit of B as he will advance to a better priority position. A prolonged period reduces (postpones) B’s possibility of getting better security for his claim, but it

---

<sup>39</sup> A mortgage being protected according to Sect. 25, may, however, have no effect as it may be subject to avoidance in accordance with the rules in the Seizure Act Chap. 5. One typical example: When old debt is secured by a mortgage, the mortgage may be avoided by the bankruptcy estate if it was registered during the last three months before the request for bankruptcy proceedings, which actually led to such proceedings, was received by the Court (Seizure Act Sect. 5-7, cf. Sect. 1-2).

<sup>40</sup> The Norwegian expression is “opptrinnsrett”, which has been translated with “right of promotion in creditor ranking, i.e., the right of promotion from a more junior to a more senior priority” (Craig, *Stor norsk-engelsk juridisk ordbok* (1999) p. 175).

<sup>41</sup> E.g. the mortgage is claused so that it “shall at any time have priority after NOK ...”.

<sup>42</sup> See to the following, Brækhus op. cit. pp. 230-243 with further references.

is common ground that B's expectations based upon the original terms are not protected.

Increased rate of interest on A's mortgage may affect B in two ways: The debtor will have less funds to serve his obligations towards B, and there is a risk that the accumulated interest, which is secured on the same priority as the principal, increases (see 4.6.3), thus reducing B's chances of getting paid from the proceeds of a forced sale. Neither here are objections from B relevant, provided that the actual rate of interest is within commercially acceptable limits.<sup>43</sup>

Finally, amendments regarding conditions, in particular stipulations on what constitutes "substantial default" entitling the creditor to demand immediate repayment, must also be tolerated by B. The reason for this is mainly that such stipulations are subject to Court control.<sup>44</sup>

Amendments of the types now described need not be registered. In fact, such contractual terms will seldom appear from the extract in the ship register, which is in itself an argument for not protecting the expectations which B may have had.

#### 5.4.2 Can the mortgage secure other claims than the original one?

We have two situations to consider:

(i) The mortgage is issued to give security primarily for one specified claim, but with the additional agreement that the security shall apply also to future claims which the creditor may have against the debtor.

(ii) There is no such agreement at the outset, but at a later stage it is agreed that the mortgage shall be security for a claim which now arises. E.g. the mortgage is paid down to 50%, and it is agreed that the "free part" of the security shall be security in respect of a new loan.

The answer to whether others with interest in the mortgaged object are obliged to accept such agreements on "filling up" or "refilling the mortgage" – provided of course that the maximum amount stated in the mortgage is not exceeded – have been heavily debated.<sup>45</sup> From many quarters it has been pointed out that the distinction between "effective" and "accommodation" mortgages is essential: "Filling" and "refilling" may to some extent be allowed under the latter type,<sup>46</sup> but not under the former one. Here it is not necessary to go into this discussion<sup>47</sup> as we may take it as the solid main rule that mortgages on ships are of the "accommodation" type (see 4.4 above).

<sup>43</sup> See e.g. Court of Appeal decision in RG 1984 p. 543.

<sup>44</sup> See above in 4.7 *in fine* on the Court's powers under the Contracts Act Sect. 36.

<sup>45</sup> See to this section, Falkanger, Tingsrett (5. ed. 2000) pp. 680-713 with further references.

<sup>46</sup> This was accepted in two Supreme Court decisions, see Rt. [Supreme Court Reports] 1909 p. 117 and Rt. 1910 p. 177.

<sup>47</sup> The tendency throughout the later years has been to accept that "refilling" is permitted also in respect of "real" mortgages - one important factor being the difficulties in drawing the boarder line as well as the regulations on mortgages in the Aviation Act of 11th June 1993 no. 101 Sects. 3-29 and 3-30. See Falkanger *op. cit.* pp. 702-703.

When discussing the indicated problems is necessary to distinguish between the positions of creditors with rights based upon contract and enforcement.

(a) *B is mortgagee.*

As a mortgagee B must accept that A's mortgage is "refilled". E.g., A's original mortgage is for 100, when the debt is paid down to 60, there is "space" for securing a new claim up to 40. But this cannot be done when:

- it has been registered that the amount owing is reduced to 60, or
- the creditor has given a receipt on down payment to 60 on the (negotiable) mortgage document, or
- A has given a declaration that he will not "refill" the mortgage. When B is asked to extend credit with security in the vessel, he will in most cases ask A what the outstanding amount under A's mortgage is. An answer stating an amount less than the amount appearing from the mortgage may be construed as a promise not to contribute to a "refilling"; but in order to be safe B should not rely upon anything but an express declaration to that effect.

"Refilling" may be based upon an agreement of type (i) above, while the actual "refilling" depends upon a later agreement. A typical situation is that bank A grants the shipowner a new credit facility. At this stage A may have knowledge of a previous agreement between the shipowner and B which implies the use of the "free space" - in the example above: that B shall have priority after 60. With such knowledge, the Supreme Court<sup>48</sup> has stated, that it would be contrary to "a duty of loyalty" if A took advantage of the original agreement to secure its engagement number 2 (in fact contributing to owner's breach of contract in relation to B). Obviously, B ought to clarify the position and have an unequivocal understanding with A before giving credit to the shipowner, but the Court's reasoning is based upon that knowledge on the part of A is sufficient to prevent "refilling". Having in mind the usual attitude to "good faith"-problems it might have been expected that the Court would have said that "ought to have known" is in the same category as knowledge, but the Court says expressly that there is no duty of inquiry on the part of A before "refilling".<sup>49</sup>

(b) *B is the holder of an enforcement lien.*

When B is a mortgagee he has to accept that A has got reserved a certain "space" for securing A's claims. If B does not find this acceptable, he may refuse to give the owner credit. But when B is an enforcement lien holder, the

---

<sup>48</sup> See Rt. 1994 p. 775. The decision was actually on security in documents giving the right to use and dispose of an apartment - with no requirement as to stating a maximum for the secured amount. Therefore, the question has been raised as to whether the decision is applicable to mortgages on real property. In my opinion the decision is clearly applicable, see Falkanger op. cit. p. 705.

<sup>49</sup> On this position of the Court, see Falkanger op. cit. pp. 705-706.

situation is quite different.<sup>50</sup> Now B is entitled to get the best security available at the time of enforcement and to advance prioritywise when A's mortgage is paid down; he is not obliged to accept being "pushed backwards" because of an agreement between the debtor and A.<sup>51</sup>

But in special circumstances even the enforcement lien holder has to accept "refilling", viz.:

- when A at the time of "refilling" had no knowledge of B's right. The crucial question is: Has A an obligation to examine the ship register in order to ascertain whether there exists an enforcement lien which prevents "refilling", or is the burden upon B to notify A? The general attitude in legal theory has been that the obligation rests upon A, but the Aviation Act of 11<sup>th</sup> June 1993 no. 101 Sect- 3-30 says that "refilling" cannot be done "after registration of an enforcement lien of which the mortgagee has been informed or otherwise had knowledge of." As of today it is uncertain what impact this stipulation will have upon general mortgage law.<sup>52</sup>
- when A has committed himself so that he cannot withdraw from the engagement without loss. The example usually referred to is a building project where credit is supplied by the bank as the project progresses. In the initial stages the value of the building (the security) may be less than the credit supplied; it is during the later stages that the value of the building increases so that it equals and finally exceeds the credit. Here it is commonly accepted that A can continue supplying credit without losing priority to the lien holder.<sup>53</sup> This exception has now been codified in the Aviation Act Sect. 3-30: Even with knowledge of a registered enforcement lien "refilling" is possible if the mortgagee cannot interrupt (Norw.: "ikke godt kan avbryte") the credit relationship without risking a loss.

(c) *Bankruptcy* presents additional problems.

First of all, when filling or refilling requires an agreement with (an acceptance from) the debtor, a minimum requirement is that this is done prior to opening the bankruptcy proceedings.<sup>54</sup> If this is so, probably it is sufficient that the mortgage under which the new credit is secured, has been registered at least one day prior to opening bankruptcy proceeding, see 5.3 above on MC Sect. 25. There is, however, one important reservation: The bankruptcy estate may have the security set aside in accordance with the rules on avoidance in the Seizure Act Chap. 5. There are a number of different situations which cannot be discussed

---

<sup>50</sup> See Falkanger *op. cit.* p. 709, cf. pp. 695-698. On the bankruptcy situation, *see* pp. 709-713.

<sup>51</sup> This may give difficult priority questions: "Refilling" may be acceptable in relation to B as a second priority mortgagee, but not in relation to C as a third priority enforcement lien holder.

<sup>52</sup> It is the opinion of the present writer that the rules in the Aviation Act on filling and refilling (using the reserved part of the security object) will be applied also when the security is a ship or real property, *see* Falkanger *op. cit.* p.709.

<sup>53</sup> This is not necessarily to the detriment of the enforcement lien holder: Further credit may raise the value so much that also the lien holder is better off.

<sup>54</sup> *See* Bankruptcy Act Sect. 100.

here.<sup>55</sup> We have to restrict ourselves to mentioning that the important principle is that security established in the last three months period before a bankruptcy can be avoided when the claim secured is "old debt" (did not arise at the same time as the credit was established, i.e. when it was agreed to utilize the "free space" under the mortgage).

## **6 The Effects of Mortgaging - when Underlying Claim is not Paid**

The dominant effect of a mortgage is, of course, the right to seek satisfaction from the security when the amount secured falls due - either ordinarily or because of extraordinary circumstances. This right is regulated in CoE in a mandatory way; i.e., the parties cannot agree in beforehand that the creditor in case of default shall be free to obtain satisfaction in other ways than those described in CoE (Sect. 1-3). But when a default situation is a fact, then there are no restrictions. Now the parties may enter into an agreement that settlement shall be sought outside the Code system.

The Code has several possibilities for settlement in default situations: forced use of the ship with payment to the creditor from the revenues, or more practical: forced sale of the ship - either at a forced auction or otherwise with the assistance of a professional shipbroker appointed by the Court.

Here we shall give but a brief outline of the rules on forced sale.<sup>56</sup>

The basic requirement is, of course, that the creditor has a claim which is due and not paid. And in addition the claim has to be reasonably clear, which is formalized in the requirement that a so-called "enforcement ground" must exist. The CoE operates with a number of such grounds, one of which is a final judgment, see Chap. 4. In practical life there are special grounds which are invoked. Thus the registered mortgage or the registered enforcement lien is a sufficient ground, provided that a preliminary notice of imminent enforcement has been given (Sect. 11-2).

When the Court (see Sect. 11-3) accepts the application it will in most instances prefer a forced sale which as far as possible shall be carried through as a voluntary sale (Sect. 11-12). This means that a shipbroker, being appointed as the assistant of the Court, tries to obtain offers on the vessel. An offer has to be accepted by the claimant creditor (Sect. 11-28), where after the Court takes over (Sects. 11-29 and 11-30): It shall check that the rules have been followed and be reasonable certain that further sales attempts will not give a higher offer. Satisfied in those respects, the Court can confirm the offer, provided that the offer is sufficient to cover all encumbrances on the vessel with better priority than the claimant's lien (Sect. 11-20). In addition to such a confirmation (Sect. 11-30) the Court has to make an order on the distribution of purchase price (Sect. 11-36). Both when distributing the funds and when ascertaining that Sect. 11-20 is complied with, interest must be taken into account; this is done on the

---

<sup>55</sup> See Falkanger op. cit. pp. 710 *et seq.*

<sup>56</sup> For a more comprehensive account of the rules, see Falkanger, *Forced Sale of Vessels - according to Norwegian Law*, Simply Yearbook 1999 (=MarIus no. 247) pp. 3-27.



basis that interest is calculated up to a date ("settlement day") which is three months after the day when the shipbroker left the matter to the Court (Sect- 11-27). Finally, when the purchase price is paid, the Court will issue a document, evidencing transfer of title to the buyer.