

THE
TRANSPORT
FINANCE LAW
REVIEW

FIFTH EDITION

Editor
Harry Theochari

THE LAWREVIEWS

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PREFACE

The Transport Finance Law Review is intended to provide the industry with a guide to transport finance today, in each of the key jurisdictions globally in which aircraft, rolling stock and ships are financed.

The transformation of the asset finance industry triggered by the global financial crisis has been well-documented. Before the crisis, traditional asset finance, in the form of bank debt, had been the mainstay of the transport sector.

Now, regulation introduced with the intention of preventing future crises, such as Basel III and Basel IV, has made long-term lending to the transport sector significantly less attractive. This has, in part, led certain banks to exit the asset finance market altogether, by selling all or part of their loan books to help them to meet their capital requirements.

At the same time, the aviation, rail and cruise industries have required a steady stream of finance to acquire additional assets to help them to meet growing demand from passengers, particularly in developing economies. This, coupled with the introduction of increasingly sophisticated and more costly technology, including fuel efficient technology, high-speed rail and high-specification ships, is leading to increased funding requirements in many areas of the transport sector.

Asset finance in its traditional form is now available from relatively few banks, who in turn are prepared to lend to relatively few names, which are usually leaders in their relevant sectors. Tenors tend to be shorter, and borrowing more expensive. It is clear that debt finance alone is no longer sufficient to meet the needs of the global aviation, rail and shipping industries. Other financiers and investors have recognised this and have identified significant opportunities to secure returns, using innovative new funding structures, and often in collaboration with traditional lenders who have remained in the market.

These developments have meant that legal advisers to the transport finance sector are now required to provide a far broader set of legal skills and market knowledge than has previously been required.

At the time of writing, capital is readily available to much of the aviation industry, which is benefiting from rising demand for air travel and industry forecasts anticipating a doubling of passenger numbers in the next 20 years. The capital markets are also open for business for the aviation industry, and there is a flow of equity investments from both hedge funds and private equity as well as large-scale investments from Asia (and China, in particular).

In the rail market, passenger demand is also increasing and significant investment is being made in new and existing rail assets globally. Increased appetite for high-speed rail and

light rail transit is encouraging rail market participants to look outside of their traditional markets in search of new opportunities.

Attitudes towards the shipping industry are generally more cautious. The amount of debt finance available to shipping has fallen dramatically, and alternative sources of finance, such as private equity, hedge funds, bond markets and capital markets, have also reduced greatly. This is not surprising to many as shipping gradually emerges from possibly the worst recession it has ever experienced in modern times, impacting across the entire spectrum of the industry.

Today, capital markets and private equity structures now account for a substantial proportion of the transport finance market. A number of private equity players are buying loans from traditional banks at a large discount to see immediate returns. Others have invested directly in shipping in the belief that the cyclical nature of shipping will result in returns in the medium to long term. In the aviation industry, leasing firms, who are frequently supported by private equity players, now account for around 40 per cent of the major aircraft manufacturers' sales. In the case of rail, new investors are being attracted to the industry by the commitments made by governments worldwide to improve existing infrastructure and invest in new, sophisticated rail links.

Against this evolving financing landscape, disruptive technology is bringing about further changes. Artificial intelligence, distributed ledger technology such as blockchain, and low carbon technology are creating new funding requirements, as well as bringing new participants into the transport sector, with new ideas for raising finance.

The aviation, rail and shipping industries each have their own unique characteristics and need lawyers with a deep understanding of how each of these complex industries operates. A detailed knowledge of the principles of asset finance is now also required, combined with the ability to advise on new capital markets and corporate structures. In addition, while the majority of asset financings in the transport sector tend to be governed by New York or English law, an understanding of the principles of local law in the key jurisdictions in which transport assets are registered is also of great importance.

We have sought contributions from jurisdictions that play a leading role in the financing of transport assets. Each chapter provides an overview of the transport finance industry in these jurisdictions, with an analysis of how key lenders have changed over the past five years and how the financing of assets has developed as a result. Contributors have provided an overview of the legislative framework for transport finance and financial regulation affecting lenders to the transport sector. Authors have also been asked to review any significant innovations and notable recent and pending financings and cases, and to provide assessments of how the transport sector is likely to continue to develop in their markets.

I would like to thank the contributors to this volume. Their efforts are deeply appreciated and represent a substantial contribution to the transport law library as the sector continues its transformation.

Each contribution reflects the significance of the transport sector today, and the need for readily available funding for industries that underpin the global economy by transporting people and commodities around the world every day.

Lawyers have had to become increasingly nimble as clients require advice on developing intricate joint-venture agreements and complex capital market products, and increasingly on the opportunities and threats presented by disruptive change throughout the transport sector.

It is an incredibly exciting time to be a lawyer in this field, as our contributors demonstrate in the following chapters.

Harry Theochari

Norton Rose Fulbright

London

April 2019

COMPLIANCE OF TAX LEASE FINANCINGS WITH THE EUROPEAN STATE AID REGIME

*Christine Ezcutari and Yann Anselin*¹

One of the key issues for shipowners, aircraft owners or rail companies is to find the relevant financial resources to finance the acquisition of the assets used for their business operations at the cheapest price available. This has become even more problematic after the financial crisis suffered by the relevant players following the Lehman Brothers bankruptcy.

While secured lending was the most traditional way of raising finance, asset finance solutions through leasing and hire purchase agreements have been designed specifically to help businesses overcome the challenges of raising the necessary capital to purchase new assets. This provides a more targeted option than securing an overdraft or bank loan, and allows companies to spread their payments over a longer time frame to ease the cash-flow impact.

Some limited jurisdictions within the European Union offer tax benefits and tax allowances, which makes lease finance structures an even more interesting way of raising finance. In a context where the financed asset is a movable asset, and where companies are less reluctant to register their asset or incorporate the asset-owning company in the most economically advantageous jurisdiction, studying which jurisdiction offers an advantageous tax lease-based structure is of interest to many potential borrowers.

In a typical tax lease structure, the bank will incorporate a special purpose vehicle (the owner), which will acquire the asset to be financed. The owner will then lease the asset to the client of the bank, the company operating the asset (the lessee). The payment of the rentals due under the lease by the lessee will be used by the owner to pay all the sums due under the loan agreements it will enter into to finance the acquisition of the asset. Payment of rental under a finance lease may be distinguished from rental under an operating lease on the basis that, rather than paying exclusively for the use of the asset, the rental paid will be calculated so that, over the term of the lease, the lessee will reimburse the owner for its acquisition and financing costs for the asset. The specificity of the tax lease in comparison with a simple finance lease transaction is that the owner will pass on to the lessee, through the calculation of rentals and termination sums due under the lease by the lessee, all or part of the benefit to the owner of any capital allowances or any other tax benefits that it is able to claim in respect of its cost of acquiring the asset under the applicable tax laws.

Several Member States of the European Union have introduced such tax schemes in their legislation. For example, the French market has developed a tax lease structure that enables French banks to provide to their customers a cost saving of 5–10 per cent compared to a traditional loan-based financing. This type of financing does not rely on a structure provided as such by the French Tax Code, but is based on a combination of several features of

¹ Christine Ezcutari is a partner and Yann Anselin is a senior associate at Norton Rose Fulbright LLP.

French tax law, namely: (1) tax consolidation enabling the owner to transfer to its group any loss triggered by the owner for the group to pay less tax; (2) depreciation of the asset enabling the owner to benefit from an amortisation of the asset that will generate a tax-deductible loss during the first phase of the financing; (3) the advantageous tax treatment of the sale of the shares in the owner to the lessee, which is an indirect way for the lessee to become at some point the beneficial owner of the asset; and (4) in shipping finance transactions, the election of the advantageous tax tonnage scheme by the lessee once it acquires the shares in the owner.

In Italy, the 2008 Financial Act (Law No. 244 of 24 December 2007) also introduced a tax lease scheme to encourage certain financing transactions for the building of ships that require a crew of at least six persons.

The question arises as to whether such tax lease financing schemes could constitute indirect state aid providing some European jurisdictions with an unfair advantage in comparison with others, which would be prohibited by European state aid legislation.

While the Commission has no direct authority over national tax systems, it is indeed competent to investigate whether certain fiscal regimes, including in the form of tax rulings, constitute state aid under Article 107(1) of the Treaty on the Functioning of the European Union, and for this reason should be prohibited. This may be the case when a fiscal regime favours the recipient of the tax benefit with respect to its competitors and thus distorts competition on the market.

Two judgments of the European Court of Justice on 14 April 2016 and 28 July 2018 relating to the Spanish Tax Lease System (STLS) provide a useful indication in this respect.

By way of reminder, what can be referred to as the STLS saga began in May 2006 when the Commission started receiving complaints from several shipyards. Those complaints essentially argued that the STLS allowed maritime shipping companies to benefit from a 20–30 per cent price reduction when purchasing ships constructed by Spanish shipyards, to the detriment of the shipyards of other Member States.

The STLS is notably used in the context of ship purchasing where income tax discounts are granted to operators that invested in an economic interest grouping (EIG) for the purpose of acquiring newly built ships from a shipyard through leasing contracts with a view to later selling the ships to a shipping company; the latter benefiting in turn from a considerable price reduction for the ship purchasing. These tax discounts notably stem from the Spanish tax rules that enable an accelerated depreciation, over three to four years, of payments made under a leasing contract; and an early depreciation to be brought forward so that it starts before the asset becomes operational; that is, as soon as construction begins.

Hence, accelerated and early depreciation increases the costs of the EIG and creates losses for it, which the investors can deduct from their tax bases.

Following the opening of a state aid investigation into the STLS in June 2011 – and perhaps sensing the risk that STLS breaches state aid law – the Kingdom of Spain notified the Commission that it had introduced new legislation on early depreciation. This new legislation introduced amendments clarifying, in particular, that early depreciation was not being subject to prior authorisation and was available for all types of assets.

Before even adopting any position on the former regime, the Commission declared this amended new regime compatible with state aid rules on 20 November 2012 (the Decision).

Key to the Commission's assessment was that this new early depreciation regime did not entail advantages accruing exclusively to certain undertakings or to certain sectors of activity. As a reminder, tax measures can amount to state aid if they are selective (i.e., provided that the criteria applying to the derogatory tax burden must 'be such as to characterise the

recipient undertakings, by virtue of properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring ‘certain’ undertakings or the production of ‘certain’ goods’).²

However, the Commission found that the acquisition of assets financed through financial leasing contracts is generally accessible to companies of all sectors and sizes. In addition, leasing contracts and early depreciation can be used with respect to assets built in (originating from) Member States other than Spain. The General Court confirmed this analysis on the following grounds: the measure applied to all undertakings that are subject to income tax in Spain; any kind of asset acquired by any kind of company active in any sector of the economy can be the subject of a leasing contract; and if the measure required certain conditions, as regards the asset being custom-built and as regards the construction period and pre-financing, these are justified because they offset the fact that a lessee has to bear the financial cost of a significant part of the asset before it actually becomes operational.

This assessment was confirmed on 14 April 2016 by the European Court of Justice.

On 25 July 2018, the European Court of Justice subsequently found by contrast that the former STLS scheme did constitute state aid.³ Interestingly, the General Court had previously concluded otherwise on two grounds. The first was that, because the EIGs are tax transparent, only the investors could be regarded as beneficiaries of the advantages arising from the tax measures at issue and it was therefore by reference to the investors alone that the condition relating to selectivity had to be examined. The second was, in this respect, that the advantages granted to investors were not selective because the advantages arising from the STLS are available to any undertaking

The European Court of Justice overturned both findings. It found that the former STLS could also constitute state aid in favour of the EIGs, as those perform an ‘economic activity’ (the acquisition of vessels through leasing contracts) and, in this context, apply to the tax authority for the benefit of early depreciation of leased assets, which they are granted in the first place. The fact that they pass on all benefits to investors is irrelevant for the classification of a measure as ‘state aid’. The General Court therefore erred in law in failing to examine whether the former STLS conferred on the tax authority a discretionary power such as to favour, *de jure* or *de facto*, the activities carried on by the EIGs involved in the STLS. In relation to investors, the European Court of Justice found that the mere fact that the advantages arising from the STLS are available to any undertaking does not mean they cannot be selective. According to established case law, with regard to a national measure conferring a tax advantage of general application, the condition relating to selectivity is satisfied where the Commission is able to demonstrate that that measure is a derogation from the ordinary or ‘normal’ tax system applicable in the Member State concerned, thereby introducing, through its actual effects, differences in the treatment of operators, although the operators who qualify for the tax advantage and those who do not are, in the light of the objective pursued by that Member State’s tax system, in a comparable factual and legal situation. The General Court therefore failed to assess whether the Commission had established that the tax measures, by their practical effects, introduced differentiated treatment between operators in a comparable factual and legal situation. The European Court of Justice referred the case back to the General Court on those points and the General Court’s judgment is pending.

2 Judgment in *Netherlands Maritime Technology Association v. Commission*, T-140/13, ECLI:EU:T:2014:1029, Paragraph 99.

3 Judgment in *Commission v. Spain and Others*, ECLI:EU:C:2018:591.

The two judgments indicate that the compatibility of tax lease schemes in the European Union will greatly depend on whether they are selective or not in their application. The fact that the advantages they create are in principle available to any operator is irrelevant in that respect.

BELGIUM

*Benoît Goemans*¹

I INTRODUCTION

i The transport finance industry

Transport industry

Located at the centre of the European Union and hosting its main institutions, Belgium plays a crucial role in all means of transportation.

Belgium has five international airports, among which Brussels National Airport caters for 25 million passengers and half a million tons of cargo each year.

The second largest European sea harbour is located in Belgium (Antwerp) and shipowners increasingly register ships under the Belgian flag, as it combines an attractive tonnage tax regime with a label of rigour.

The first railway on the European continent was built in Belgium and ever since rolling rail equipment has been developed and constructed in Belgium.

Finance industry

While local banks will finance equipment in inland shipping, borrowers for other means of transportation will typically rely on foreign lenders. The local legal profession is nevertheless present for the drafting and registration of Belgian instruments such as mortgage deeds, pledge on assets and revenue, assignments etc. Both the legislation and the legal profession are notably efficient to protect creditors' rights thanks to fast attachment procedures, to procedures on the merits specifically designed for undisputed claims and the swift recognition and enforcement of foreign judgments and other enforceable titles.

ii Recent changes

The new Belgian act on security interests² providing for the registration of pledges (equivalent to mortgages) creates new opportunities for the financing of aviation and rail assets.

1 Benoît Goemans is the founding partner of Goemans, De Scheemaeker & De Wit (GDS Advocaten).

2 The Act of 11 July 2013 (Moniteur belge 2 August 2013), which entered into force on 1 January 2018 (following an amendment by Act of 25 December 2016, Moniteur belge 30 December 2016) has replaced Title XVII of Book II, Belgian Civil Code. See also <https://gdsadvocaten.be/bulletins/new-act-on-security-interests/> and B. Goemans, 'Les nouvelles dispositions légales belges sur les sûretés mobilières', *Droit Maritime Français*, No. 809, January 2019, page 67.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Conflict of laws

International conventions binding Belgium supersede domestic law.³ In the absence of an applicable international convention, the Code of International Private Law (Code IPL) determines the which country's law will apply.⁴

Out of its own scope of application or by virtue of article 89 of the Code IPL, the EC Regulation No. 593/2008 of the European Parliament and of the Council of 17 June 2008 (Rome I) shall determine the law applicable to contracts.⁵

Substantive law on contracts

Under Belgian law, contracts are, in general, governed by Articles 1101 to 1369 of the Civil Code. Specific provisions of the Civil Code rule a number of contracts in particular, such as the:

- a* loan agreement: Articles 1874 to 1914;
- b* power of attorney: Articles 1984 to 2010;
- c* bail or guarantee: Articles 2011 to 2043 octies; and
- d* lease: Articles 1708 to 1712.

Substantive law on security interests

Aviation and rail assets

Belgium is not a party to the Convention on International Interests in Mobile Equipment, 2001, Cape Town (Cape Town Convention). The rights of creditors on aviation and rail assets are, as any other movable asset (except ships) governed by the general provisions of Title XVII on pledges and Title XVIII on liens and mortgages in Book III of the Civil Code.

Ships

The registration of ownership, of the mortgage and of the bareboat charter of ships is governed by the Act of 21 December 1990.

Belgium is a party to the International Convention on Maritime Liens and Mortgages, 1926, Brussels (1926 Convention) and incorporated the substantive provisions thereof in Book II, Code of Commerce (Code Comm). It should be noted, however, that the proposed new Maritime Code submitted to the Chamber of Representatives provides for a denunciation of the 1926 Convention, and an adoption of the 1993 Convention.⁶

Revenue

The aforementioned Title XVIII also governs the pledge of revenue.

3 Article 2, Code of International Private Law (Code IPL), Act 16 July 2004, Belgian official journal, 27 July 2004.

4 Article 2, Code IPL.

5 Both as within the scope of application of this Regulation and by virtue of Article 98 of the Code of International Private Law.

6 International Convention on Maritime Liens and Mortgages, Geneva, 6 May 1993.

ii Specific practices

Air and rail

Until 31 December 2017, mobile equipment other than ships could not be specifically mortgaged. Other security constructions were possible but not so effective, or with undesired side effects.⁷

The new provisions on Security Interests (the aforementioned Title XVII, Book II, Civil Code) entered into force on 1 January 2018, and now offers, subject to conditions and restrictions, a preferred right to the pledgee of any chattel, such as aviation or rail equipment, although the use and possession thereof is with the borrower, provided this pledge is registered in a public register of pledges set up to that end.⁸

Article 8 of the New Act on Security Interests expressly provides for the pledging of future assets, so that air and rail assets under construction or to be constructed can be pledged under the aforementioned New Act.

Shipping

Claims arising out of the financing of ships are ordinarily secured with a mortgage. This applies to both existing ships and ships under construction.⁹

In addition to the mortgage, other instruments are a pledge on receivables, an assignment of insurance indemnities and (until 31 December 2017) a general pledge of the business, including all movable assets and receivables. Duties of the ship builder are typically secured by a performance guarantee.

The pledge of the shares of the borrowing and ship owning company could also be helpful as an addition to other security interests, as it will enable the lender to acquire control over the asset when the need thereto appears. This control may prove of little help if too late, say, once other creditors have arrested the ship for significant amounts or once insolvency proceedings are initiated.

The lease purchase is also an option, but, as long as the ship is still under lease, the financier characterises as a registered owner. As such, he or she is exposed in Belgium and other jurisdictions, to no-fault liabilities, both contractual and non-contractual.¹⁰ Once the purchase option is exercised, the financier will characterise as a seller and specific attention should be given to the risk of liabilities for hidden defects hard or impossible to waive by contract.

7 By contrast it was possible to record a pledge on the entire business, including all movable assets, which is still possible. Also, it was customary, until 31 December 2017, in the absence of a pledge register on particular assets, to structure the financing of the mobile equipment through the mechanism of the preferred right of the unpaid seller. This mechanism required the lender to be characterised as the seller, creating issues in respect of the warrantee for hidden defects provided for by imperative statutory provisions that could not be contracted out. The other option is the lease purchase agreement. It is possible to contract out to a large extent the liability of the lessor towards the lessee. However, some jurisdictions may provide for faultless liability of the owner, which is the status of the financier during the lease. Upon the lessee exercising the purchase option, the lessor becomes a seller. The law is severe for the seller's duty to hold the purchaser harmless for hidden defects and it is difficult, if at all possible, to contract this out.

8 See also <https://gdsadvocaten.be/bulletins/new-act-on-security-interests/> and also B. Goemans, 'Les nouvelles dispositions légales belges sur les sûretés mobilières', *Droit Maritime Français*, No. 809, January 2019, page 67.

9 Article 14, 1° Royal Decree 4 April 1996 and Article 8 Maritime Code.

10 Article 46, Section 2 Maritime Code.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The Regulation of 4 March 2014 of the National Bank¹¹ implements Regulation (EU) No. 575/2013 in Belgium.

ii Supervisory regime

The Belgian National Bank is in charge of the prudential supervision of banks.¹²

IV SECURITY AND ENFORCEMENT

i Arrest (attachment)

The term 'arrest' will be used in the meaning of a detention or restriction on removal of an asset to secure a claim.¹³ It does not include the seizure of such asset in execution or satisfaction of a judgment or other enforceable instrument. Arrest in such meaning is not a step, at least not a necessary step, to a judicial sale.

The arrest does not require an enforceable title. The arrest as such does not cause a priority ranking not otherwise acquired. The purpose of the arrest is not to proceed to the judicial sale, although it may so end up, but on the contrary, the release against payment or security. In practice, the arrest in Belgium, except of airplanes, proves to be an extremely fast and effective tool for the collection of receivables.

Aeroplanes

Belgium is a party to the 1933 Airplane Arrest Convention,¹⁴ which, by virtue of its Article 3, heavily restricts the creditor's ability to arrest an airplane. It should be stressed that this is the arrest as defined hereabove. This does not preclude at all the executory seizure for the purpose of a judicial sale on the basis of an enforceable title (see Section IV.iii).

Ships

A ship arrest will be authorised and maintained on the mere but serious allegation of a claim, not requiring an enforceable title. Arrest of bunkers may be an alternative to a ship arrest, if for some particular reason a ship arrest is not permissible.

Creditors have a clear preference for arresting ships in Belgium.¹⁵

The reasons are:

- a* some 15,000 calls a year at just one of its sea ports (Antwerp);
- b* by far the highest number of ships sheltering in locked docks on the European Atlantic coast, avoiding the risk of escaping while under arrest;
- b* the ability to cash or secure a claim related to the ship, regardless of whether or not the shipowner is the debtor;

11 Approved by Royal Decree of 10 April 2014, Official Journal 15 May 2014.

12 Article 36/2, Section 1, Act of 22 February 1998.

13 Also see the definition, in Article 1.2, International Convention for the Unification of Certain Rules relating to the Arrest of Sea-Going Ships, Brussels, 10 May 1952 (Ship Arrest Convention).

14 International Convention for the unification of certain rules in respect of the arrest of airplanes, 29 May 1993 (1933 Airplane Arrest Convention).

15 See also <https://gdsadvocaten.be/maritime-claims-collection-ship-arrest/>.

- c the ability to arrest sister ships;
- d the countersecurity being very seldom required.

Belgium ratified the 1952 Ship Arrest Convention¹⁶ and incorporated these provisions in the Belgian Judicial Code.¹⁷ As a result of the incorporation in domestic law, the rules as set out in the 1952 Ship Arrest Convention apply, whether or not the ship to arrest is flying the flag of a state party to the 1952 Arrest Convention.

Requirement

The judge shall authorise the arrest if the applicant presents the allegation of a maritime claim. A maritime claim is a claim in the meaning of the aforementioned 1952 Arrest Convention, which includes more or less all types of claims,¹⁸ except insurance premium or calls. A judgment on the substance is not required to obtain the authorisation to arrest.

No escape route

Besides the fact that sailing while under arrest would constitute a penal fact, the arrested ships cannot, as a practical matter sail, because in most cases docks are behind locks and because she will need a pilot to reach the sea. The arrest is notified to the lockmaster and to the corporation of pilots.

To secure shipowner's or charterer's debt

To arrest a ship, it is not required that the shipowner is, on the substance, the debtor of the maritime claim to secure.¹⁹ As an example, a ship arrest will be authorised and maintained to secure a bunker claim, although it is expressly agreed only the time or bare boat charterer is held²⁰ and not the registered shipowner.

16 International Convention for the Unification of Certain Rules relating to the Arrest of Sea-Going Ships, Brussels, 10 May 1952, (1952 Arrest Convention).

17 Articles 1467 to 1469.

18 According to Article 1.1° of the 1952 Ship Arrest Convention and Article 1468 Belgian Judicial Code a ship can be arrested to secure claims arising out of: (1) collision; (2) loss of life or personal injury; (3) salvage; (4) 'agreement relating to the use or hire of any ship whether by charter party or otherwise'; (5) carriage of goods; (6) loss or damage to goods; (7) general average; (8) bottomry; (9) towage; (10) pilotage; (11) goods or materials supplied to a ship for her operation or maintenance; (12) construction, repair or equipment of any ship or deck or dock charges and dues; (13) wages of masters, officers, or crew; (14) master's disbursements, including disbursements made by shippers, charterers or agents on behalf of a ship or her owner; (15) disputes as to title to or ownership; (16) disputes between co-owners of any ship as to the ownership, possession employment or earnings of that ship; and (17) the mortgage or hypothecation of that ship.

19 Cour de Cassation, 10 May 1976, *Omala*, Arr. Cass., 1976, 1008, Pas., 1976, I, 969 ; Cour de Cassation, 1 October 1993, *Heinrich J*, J.P.A., 1994, 132 (also see next footnote); Cour de Cassation, 23 May 2003, 'Atlantic Island', www.juridat.be.

20 Cour de Cassation, 1 October 1993, *Heinrich J*, J.P.A., 1994, 132, Cour de Cassation, 1 October 1993, R.W., 1983, 1994, 357. In *Heinrich J*, the bunker order was rubberstamped with the express mention that the bunker order was placed by the time charter not binding the registered owner. Belgium's highest court decided that such circumstance did not affect the right to arrest the *Heinrich J*, ultimately causing the registered owner to pay for the charterer's debt.

Sistership

A creditor can arrest any ship in the ownership of his or her debtor to secure his or her maritime claim.²¹ Courts hold that if it derives from a set of facts and circumstances that are consistent in pointing to piercing of the corporate veil between the debtor and the registered owner of another ship so that the assets of the debtor and of the registered owner of the other ship are co-mingled and form one whole, this other ship would qualify as a sister ship for arrest purposes.²²

Countersecurity

According to Article 6.1 of the 1952 Ship Arrest Convention, the judge can impose a countersecurity to be posted, but that is seldom ordered.

Wrongful arrest

The court may impose a compensation for wrongful arrest. The judge authorises the ship arrest following an *ex parte* application to that end. The arrestee may oppose this authorisation. The mere fact that, after hearing the arrestee, the judge lifts the arrest does not, *in se*, establish a liability of arrestor. Neither does the sole fact that the claim secured by a ship arrest eventually fails before the court judging the claim on its substance cause a liability for wrongful arrest. A careful inspection of the claim and a carefully drafted application do protect the arrestor against a risk of liability. A court would impose a compensation for wrongful arrest if the arrestee establishes that his or her ship was arrested for no other purpose than damaging while the arrestor knew perfectly well the arrest would be lifted by the judge when hearing the opposition of the arrestee.

Cash or security

The result of the arrest is that the ship remains detained until the claim is settled or secured by a bank guarantee. When the debtor has no good defence on the merits, the shipowner will often pay cash because when the claim is not reasonably disputable that is by far the best option (even if the charterer and not the shipowner is the debtor). The other option is the security: the ship should be released against posting security. Such security shall be so worded to secure the claim even if the shipowner is not the debtor. One way to realise the security is to obtain a judgment on the merits. For undisputed claims it is rare that the shipowner will resist as far.

Insolvency order

Insolvency orders seek to hinder the individual pursuit of claims. However, the 1952 Arrest Convention shall, in most cases, prevail over provisions prohibiting actions of individual creditors resulting from an insolvency order. To put it another way, an insolvency order will often not preclude a creditor to arrest a ship.²³

21 Article 3,1 1952 Arrest Convention, Article 1469, Section 1, Belgian Judicial Code (Jud. C.).

22 *Zie rpraak* in AG.

23 Judge of Seizures and Arrests of Ghent, 7 July 2009 in the matter of the arrest of the M/T Pretty Flourish.

Rolling rail assets

Rail assets are characterised as any other chattel for the purpose of arrest.²⁴ The judge shall authorise the arrest thereof to secure a claim that is due, assessed or assessable and certain.²⁵ There is no need to submit an enforceable title.

Funds and revenue

Funds and revenue may be attached, even without court authorisation,²⁶ to secure a claim that is assessed or assessable and certain.

ii Self-help

Air and rail assets

In the event of the pledgor's serious shortcoming, the judge may, at the pledgee's demand, order the remittance of the pledged asset to the pledgee or a custodian.²⁷ The pledgee is entitled to proceed to the sale of the pledged assets and can instruct a bailiff to do so, whether by means of a public auction or a private sale, upon prior notification to the pledgor.²⁸ The pledgee shall not acquire the pledged assets in a private sale,²⁹ but he or she can in a public auction, or upon the pledgor agreeing thereto.³⁰ Indeed, the pledgor and pledgee may agree thereto in the pledge agreement, or thereafter, but such clause shall state that the value of the goods shall be determined by an expert, or, for goods traded on a market, at market rate.³¹ Both during and after the self-help foreclosure, any interested party may apply to the judge to solve any dispute that may arise.³²

Ships

The judge of seizures and arrest of the place of the registration shall authorise the mortgagee to take possession, if a clause to that end is included in the mortgage deed and has so been registered.³³ As a result of this competence and jurisdiction provision, the ability to exercise the right to take possession is restricted to ships registered in Belgium.

It is untested whether the mortgagee could, on the basis of a right to sell clause and without the consent of the owner or mortgagor, proceed to a non-judicial sale. In any event, it is as a practical matter, never an option, because it would neither lift the arrests nor free the ship of debts.

24 The articles 1413 to 1422 Jud. C. govern the arrest in general, and articles 1422 to 1427 Jud. C. are specific to the arrest of chattel.

25 Article 1415, Jud. C.

26 Article 1445.

27 Article 22, New Act on Security Interests.

28 Article 48, New Act on Security Interests.

29 Article 52, New Act on Security Interests.

30 Article 53, New Act on Security Interests.

31 Article 53, New Act on Security Interests.

32 Articles 54 and 56, New Act on Security Interests.

33 Act of 4 September 1908.

iii Judicial sale

Movable air and rail assets

Upon the pledgor's default, the pledgee is authorised to proceed to a self-help foreclosure, without the need of an enforceable title (Section IV.ii 'Air and rail assets').

Ships

The judicial sale of ships speeded up significantly over recent years as a result of the ability to very quickly obtain an enforceable title and the abolishment of the second auction.

A judicial sale of a ship shall be organised and completed upon the submission of a title enforceable in Belgium to a court bailiff and conducted in accordance with the articles 1545 to 1559 Jud. Code, which provide for the notifications to the shipowner and known creditors.

A foreign insolvency order, whether issued in an EU Member State or not, shall not hinder the judicial sale.³⁴

A mortgage deed bearing the order to enforce, an enforceable domestic payment order, an enforceable EU order for payment, an enforceable judgment or an enforceable arbitration award are enforceable titles.

If such titles are originating from a Belgian authority,³⁵ then they will allow the court bailiff to proceed immediately with the executory seizure leading to the judicial sale. Hereafter we deal with enforceable titles not originating from a Belgian authority.

EU Member State

If not originating from a Belgian authority but from an authority of another EU Member State, then the judicial title will be enforceable in Belgium as an enforceable judgment rendered by a Belgian court, without the need of a court declaration of enforceability.³⁶ The court bailiff shall also proceed to the executory seizure and subsequent judicial sale upon the submission by the claimant of documents listed in Article 42.1. Among which are the certificate according to the form as in Annex I for decisions and Annex II for deeds and settlements to the Regulation Brussels I Recast. Prior to relying on a mortgage deed, one should check whether an Annex II certificate can be obtained.

Switzerland, Norway, Iceland, Singapore, Mexico and Montenegro

If the title originates from Switzerland, Norway or Iceland, then the enforcement thereof will be governed by the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, signed in Lugano on 30 October 2007. Its effects are materially the same as the (old) Brussels I Regulation of 2000.

34 Article 5, Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30 June 2000 and Code of International Private Law, Act of 16 July 2004, Mon. b. 27 July 2004 (Code IPL), Article 121. See also <https://gdsadvocaten.be/insolvency-and-ship-mortgage/>.

35 The term 'authority' is not restricted to a court or judge, it also includes the notary and the magistrate in the meaning of Article 1394/24 Jud. C.

36 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I Recast Regulation). The defendant may apply to the court to hear the refusal of the enforceability on a restricted number of grounds. The defendant may apply to the court to hear the refusal of the enforceability on a restricted number of grounds.

If the judgment was rendered by a Court of Singapore, Mexico or Montenegro, then the enforceability of the judgments shall be governed by the 2005 Convention on Choice of Court Agreements,³⁷ which provides for a swift *exequatur* without review on the merits, and provides for a restriction of grounds for refusal of enforceability.

All other

According to article 22, Section 1, Code IPL, a foreign judgment, which is enforceable in the country where it was rendered, shall be declared enforceable in Belgium by a Belgian Court of First Instance judging upon an *ex parte* application³⁸ to that end.³⁹

The Court shall not review the matter on the merits⁴⁰ and the court can only refuse the enforceability on restricted grounds provided for in Article 25, Section 1, Code IPL.

Article 27, Code IPL provides for a simple and straightforward *exequatur* of non-judicial enforceable titles, such as mortgage deeds.

*'No deal' Brexit*⁴¹

At the time of writing, the UK is scheduled to leave the EU on 29 March 2019 without a deal, so that the rejected deal, which included provisions in respect of the enforceability of judgments, is not material for the time being.

The 'no deal' Brexit will cause the Brussels I Recast Regulation of 2012 to become ineffective for the enforcement of UK judgments in the EU.

If there is no convention instead of the Regulation Brussels I Recast, a limited court intervention will be required, and restricted grounds for refusal will apply as provided for either by the 1934 bilateral Convention for the Reciprocal Enforcement of Judgments between Belgium and the UK,⁴² or the 2005 The Hague Convention on Choice of Court Agreements,⁴³ or the Belgian Code IPL.⁴⁴ It will bring back a system rather comparable to the earlier Brussels I Regulation of 2000.⁴⁵

37 Convention on Choice of Court Agreements, The Hague, 30 June 2005, ratified by the EU, Denmark, Mexico, Montenegro and Singapore. This convention was also signed, but not (yet) ratified, by China, Ukraine and the USA.

38 The applicant shall, along with his or her application, only submit: (1) the judgment enforcement of which is sought; (2) if the judgment is a default judgment, then the proof of service to the non-appearing party; and (3) a document showing the judgment is enforceable and notified or served.

39 Articles 1025 to 1034 Jud. Code referred to by Article 23, Code IPL.

40 Article 25, Section 2, Code IPL.

41 For a more detailed discussion, see <https://gdsadvocaten.be/bulletins/brexit/>.

42 Convention for the Reciprocal Enforcement of Judgments, Brussels, 2 May 1934, superseded by Brussels I Regulation (Recast), by virtue of its Article 69.

43 Convention on Choice of Court Agreements, The Hague, 30 June 2005.

44 By virtue of its Article 2, both EU law and international conventions overrule the Code IPL. By virtue of Article 25, Section 2, Code IPL, the court shall not review the merits of the case. Article 25, Section 1, Code IPL restricts the basis for refusal to make the foreign judgment enforceable to nine grounds.

45 Regulation (EC) No. 44/2001 of the Council of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, known as Brussels I Regulation.

Arbitration awards

The *exequatur* of arbitration awards is governed by Articles 1719 to 1722 of the Jud. Code without prejudice to the 1958 New York Convention⁴⁶ and other Conventions.⁴⁷

V CURRENT DEVELOPMENTS

i Developments in policy and legislation

There is a strong political will to improve the law to meet as closely as possible the enforcement needs of contracting businesses in general, and of the financing and transport industry in particular. A set of significant judicial reforms seek easier and faster litigation. A reform of contract and corporate law in general and of security interests seeks to favour business development and increase security. A new maritime code now submitted to parliament is about to modernise maritime law.

Insolvency orders shall not preclude the creditors holding security rights and other rights *in rem* (mortgages, pledges, liens etc.).⁴⁸

With the introduction of the new Titel XVII on security interests Book II, Civil Code, the Belgian legislator has clearly demonstrated the will to improve financing facilities and security, and it is likely that this is only the beginning.

The present legislature has adopted a significant amount of amendments to the Jud. C. for the purpose of speeding up proceedings. As examples:

- a The judgment of the first judge is enforceable unless otherwise decided and reasoned. This is reversing the previous system.
- b A default judgment is no longer open to rehearing.
- c The new Article 806, Jud. C. restricts the scrutiny of the judge when a party defaults to appear. The judge shall not seek to look at potential defences of the defaulting party, other than public policy and rules of law to be raised *ex officio* by the court.

ii Trends and outlook for the future

If it comes to the ratification of the 1993 Maritime Liens and Mortgage Convention, as is not unlikely to occur in the near future, the number of liens superseding the mortgage will decrease and therefore, if applicable, the ship mortgagee will improve his or her position in the event of a foreclosure in Belgium.

The recent introduction of the creditor's ability of public registration of his or her security rights in chattel,⁴⁹ such as aviation and rail assets, is a very significant move forward and worth knowing and being considered by those working out financing schemes.

It is not unlikely that the registration of security rights will be further expanded to rights such as lease purchase contracts, but it is too early to make estimates in that respect.

46 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958.

47 Such as with France, in Paris on 8 July 1899; with The Netherlands, in Brussels on 28 March 1925; with Switzerland, in Bern on 29 April 1959; with Austria, in Geneva on 11 June 1953 and Protocol on Arbitration Clauses at Geneva on 24 September 1923, and at Vienna on 16 June 1959, with Germany, in Bonn on 29 and 30 March 1954 reinstating the Protocol from Geneva on 24 September 1923 and the Convention in Geneva on 26 September 1927.

48 <https://gdsadvocaten.be/insolvency-and-ship-mortgage/>.

49 New Title XVII Civil Code.

BRAZIL

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I INTRODUCTION

The transport finance industry

Water transport is the main mode of transportation in Brazil. In 2018, the Brazilian ports handled over a billion tons of cargo, an increase of 2.71 per cent in comparison to 2017.² The increase was not as strong as the previous (growth of 8.3 per cent from 2016 to 2017), but nevertheless indicates the continuous recovery of the transport sector in comparison to the overall recovery of the Brazilian economy from the economic crisis faced by the country since 2014. Preliminary data released by the Brazilian Central Bank on 15 February 2019 indicates a growth in 2018 of 1.15 per cent in GDP, following a growth of 1.1 per cent in 2017. These are the first years of growth after two years of recession.³

By the end of 2018, the Brazilian merchant fleet had 5,646 ships: 2,534 seagoing ships and 3,112 used for domestic navigation, figures that represent a decrease of 0.4 per cent and increases of 8.7 per cent, respectively. Overall, the fleet has grown 18.4 per cent in the past five years.⁴ Apart from Brazilian vessels, there are, as of February 2019, 315 foreign-flagged ships operating in Brazil,⁵ most of them in offshore oil and gas projects.

The economic and institutional crises faced by the country and Petrobras have severely reduced investments, particularly in the oil and gas industry. The number of drilling rigs operating in Brazil has fallen from 80 to 30 rigs since 2013. The expectation is that the decrease in the number of offshore drilling rigs will continue in 2019 before the sector recovers, especially considering that in 2019, 22 rigs are under contracts that either have expired or will expire.⁶ However, the successful bidding rounds carried out in 2017 and 2018 and the ones expected to take place in 2019, combined with the strong improvement in Petrobras' financial condition indicate that investments in the area are likely to increase in the upcoming years. Petrobras has started operation of six new production platforms in

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2 1,117,311,386 tons, according to the Brazilian National Waterway Transportation Agency (ANTAQ). See <http://web.antaq.gov.br/Anuario/> (last accessed on 19 February 2019).

3 See <http://www.brasil.gov.br/noticias/economia-e-financas/2019/02/previa-do-pib-aponta-para-alta-de-1-15-em-2018-diz-banco-central>.

4 ANTAQ. See <http://web.antaq.gov.br/Anuario/> (last accessed on 19 February 2019).

5 See http://www3.dpc.mar.mil.br/sisgevi/consultainternet/relat_ait_ajb_validos_internet.asp?txtnomeemb=&txtBandeira=*&txtTipo=*&txtnrinscricao=&txtnrimeo=&txtDscBandeira=Todas%20&txtDscTipo=Todos%20&txtcontrole=22026 (last accessed on 19 February 2019).

6 See <http://www.drillingcontractor.org/in-brazil-its-two-steps-forward-one-step-back-44083>.

2018⁷ and is expected to start operation of an additional seven units in 2019.⁸ The Brazilian oil company budgeted US\$84 billion to invest between 2019 and 2023,⁹ which should boost the demand for drilling units and support vessels.

With respect to the air transportation sector, on 8 February 2019, the Brazilian Association of Airline Companies published research showing the impact of commercial aviation on the Brazilian economy.¹⁰ The research shows that the Brazilian domestic air transport market sector showed growth of 6.5 per cent compared to 2017. In December alone, domestic flights increased by 6 per cent compared with the same period in 2017. This indicates a steady strengthening in domestic demand, following the 3.5 per cent growth in 2017.

Domestic finance schemes in Brazil for the shipping industry are mainly sourced by the Maritime Merchant Fund, which is a fund that finances the construction and acquisition of ships in Brazil. The purpose of the fund is to develop the Brazilian merchant marine fleet and foster construction in Brazilian shipyards. The fund is basically formed by tax on freights payable by shippers. It is managed by the Ministry of Transport and has Brazilian public banks – such as the national development bank, BNDES – acting as financial agents.

International finance schemes for ships and aircraft that operate in Brazil, on the other hand, will typically be sourced by the US, European and Asian (more specifically Japanese and Chinese) banking markets. In the offshore shipping sector, high-value assets are normally financed thorough syndicated loan structures and in some of them export credit agencies join the pool of lenders. Bonds and private placements involving foreign investors are also used by Brazilian large-unit owners.

II LEGISLATIVE FRAMEWORK

Generally, domestic legislation affecting international finance will typically be limited to capital control regulations and tax matters. There are no capital conversion restrictions in Brazil, but international receipt and remittance of funds are subject to different registrations with, and declarations to the Central Bank and are subject to the review of the agents authorised to enter into foreign exchange agreements (e.g., brokers, banks), which act as gatekeepers to ascertain the legality of the transactions.

There is no specific legislation governing the finance of ships operating in Brazil. Projects financed with funds from the Maritime Merchant Fund or by local financiers are generally governed by Brazilian law, while parties to international finance structures normally agree to subject the finance documentation to English or New York law.

To record legal ownership over Brazilian ships, Brazil maintains a vessel registry system, which is maintained by the Brazilian Maritime Tribunal. Registration is mandatory for any Brazilian ships with gross tonnage over 100 tonnes. Proprietary security rights over

7 See <https://www.opetroleo.com.br/seis-plataformas-instaladas-ate-dezembro-de-2018/>.

8 See <https://opetroleo.com.br/novas-plataformas-da-petrobras-em-2018-e-2019-garantirao-300-mil-barris-dia/>.

9 See <https://clickpetroleo.com.br/o-mercado-de-fpso-esta-crescendo-esses-sao-os-projetos-para-assistir-em-2019>.

10 See <http://www.agenciaabear.com.br/hotnews-4/demanda-global-por-viagens-aereas-cresce-65-em-2018-informa-a-iata/>.

Brazilian ships are perfected and achieve third-party effectiveness upon registration with the ship registry, which also sets priority rules between secured creditors based on the date of registration (i.e., the first to register prevails over others).

Brazil has ratified several international conventions related to the Maritime Law, including the 1926 Maritime Liens and Mortgages Convention, incorporated by Decree 351/1935 (the 1926 Brussels Convention); the 1928 Private International Law Convention, incorporated by Decree 18.871/1929 (the Bustamante Code); and the 1982 United Nations Convention on the Law of the Sea, incorporated by Decree 1530/1995.

On the aviation finance side, aircraft leases in particular are covered in the Brazilian Aeronautical Code (the Aeronautical Code).¹¹ Operating and finance leases are the main type of contracts supporting importation of commercial aircraft into Brazil. Choice-of-law clauses are generally upheld in courts, provided, among other things, that the terms of the chosen law do not violate Brazilian sovereignty, public policy and good morals.

The Brazilian Aeronautical Registry (RAB) is the exclusive registry for aircraft and also registers contracts relating to the registered aircraft therein, such as leases and mortgages. The RAB is an owner register in the sense that ownership is obtained through registration with the RAB. Rights *in rem* over aircraft such as ownership and security interests have priority over contractual obligations.

For conventions related to aviation, Brazil has ratified the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment – the Cape Town Convention (CTC). Its implementation decree (Decree 8,008) was published on 16 May 2013. According to the Declarations Brazil approved with the CTC, there is a need to obtain authorising entry points (AEP Codes) from the RAB to effect valid registration on the international interests with the International Registry. Although Brazil is not a signatory of the 1986 Hague Convention on Trusts, the RAB recognises the role of a security trustee or of owner trustees. In Brazil, the concept of a trust raises several issues with courts and its full recognition in some instances may be questioned. A trustee would probably be treated as an agent holding interests for third parties. This issue, however, is not entirely clear. Both owner trustees and security trustees are common in Brazil. Brazil is also a signatory of the Geneva Convention, the Warsaw Convention and the Chicago Convention.

i Domestic and international law and regulation

Mandatory domestic law and regulation will apply to any transaction, party or asset subject to the Brazilian jurisdiction.

International laws and regulations arising from treaties ratified by Brazil have to be incorporated before having legal effects domestically. International treaties incorporated in Brazil are understood as being ranked at the same level as domestic ordinary federal law.

Rights and obligations created and subject to foreign laws are generally regarded as valid in Brazil to the extent they do not offend public policy, sovereignty and good morals.

ii Specific practices

As a general rule of law, contractual provisions are overridden by legislation considered to be of mandatory application in the event of conflict. This rule will apply to both domestic

11 Brazilian Federal Law 7,565/1986 (Articles 127 to 132 and 137).

and international finances when the transaction, parties or assets are subject to the Brazilian jurisdiction. In practice, however, experience shows that mandatory Brazilian laws only affect international finances more substantially in default or insolvency scenarios.

III FINANCIAL REGULATION

The Brazilian Banking Law (Law 4,595/64) created the National Financial System, which is formed by the National Monetary Council (NMC), National Council for Private Insurance and National Council for Complementary Pensions.

Banks funding the transport sector in Brazil are affected by regulations of the NMC and Brazilian Central Bank (BCB). The NMC is the main regulatory authority for the financial market, while the BCB is the supervisory authority for financial institutions.

'Resolutions' issued by the NMC represent the highest level of regulation within the Brazilian Financial Market. 'Resolutions', 'Circulars' and 'Circular letters' issued by the BCB are mandatory regulations addressing subject matters to which the law has attributed authority to the BCB.

i Regulatory capital and liquidity

Basel implementation in Brazil has primarily focused on standardised approaches to credit, market and operational risks. The BCB implemented Basel II regulations in 2007 and Basel III regulations in March 2013.

The Basel III regulations were introduced through a combination of BCB resolutions and circulars that became effective in October 2013. These regulations include: (1) definitions of regulatory capital, capital requirements and capital buffers; (2) components of risk-weighted assets; (3) risk management, liquidity management, capital management and senior management compensation; (4) disclosure of information; and (5) preventive prudential measures.

In December 2013, the Basel Committee on Banking Supervision of the Bank for International Settlements (the BIS Committee) concluded that the capital regulations in place in Brazil were compliant with the internationally agreed minimum Basel III standards.¹²

The BIS Committee, however, also pointed out that minimum capital requirement regulations (Pillar 1) on credit risk and capital buffers were found to be only largely compliant and, although this had a limited impact on the overall assessment, indicated the need for future assessments.

In relation to capital buffers, deviations were generally found to be immaterial and the Brazilian regulations to assess market risk were considered more restrictive than the Basel III standards. Regulations on legal and regulatory framework and supervisory actions regarding the supervisory review process (Pillar 2) were the other components found to be only largely compliant by the BIS Committee, and would be kept under review.

In summary, Brazil's implementation of the Basel risk-based capital regulations has been closely aligned to international standards, where 11 out of 14 assessed components were

12 See https://www.bis.org/bcbis/implementation/l2_br.pdf.

found by the BIS Committee to be 'compliant'.¹³ The components that were deemed as only largely compliant had been considered immaterial when assessing the overall compliance status.

In relation to the adoption of the Basel Liquidity Coverage Ratio (LCR) standards in Brazil and its consistency with the minimum requirements of the Basel III framework, the BIS Committee stated that the LCR regulations in Brazil are assessed as compliant with the LCR standards as of 31 December 2017, as only three non-material findings were identified during the Regulatory Consistency Assessment Programme.¹⁴ The minimum LCR requirement is being phased in from 2015 to 2019, starting at 60 per cent and increasing by 10 percentage points annually to reach 100 per cent on 1 January 2019. BIS's assessment team concluded that laws and regulations issued by regulatory authorities (resolutions, circulars and circular letters) could be considered binding in Brazil and thus eligible for the assessment and that, in a number of areas, the Brazilian rules go beyond the minimum Basel standards.¹⁵

According to the BCB, the following issues are expected to be reviewed by the BCB between 2018 and 2019: (1) treatment of banks' investments in commercial entities along with a revision of the limits on fixed assets; (2) revision of current capital requirements for bank exposures to relevant counterparties; (3) implementation of the standardised approach for counterparty credit risk framework; (4) full revision of the securitisation framework and Pillar 3 regulation.

ii Supervisory regime

The BCB is the financial institution supervisory authority in Brazil. Failure to comply with the BCB regulatory framework, and with regulations cascaded from the NMC, may result in sanctions ranging from fines to licence cancellation.

IV SECURITY AND ENFORCEMENT

Finance providers in domestic financings may require a security package including mortgage, fiduciary assignment (title-retention instrument), assignment of earnings and insurances, assignment of receivables, step-in rights under existing long-term charter contracts (typical for high-value offshore units), pledge over bank accounts, pledge over shares of special purpose companies and bank guarantees.

i Financing of contracts

For ships under construction in Brazil, finance providers may require a mortgage apart from other collateral typically required in ship finances. This type of mortgage is possible in Brazil only when the construction has started, and will affect the parts of the ship as they are built. It is not possible under Brazilian law to create the mortgage over the entire ship prior to or during its construction. Brazilian mortgages cannot be created over future assets.

It is, however, much more likely for ships under construction in Brazil that financiers require a fiduciary assignment over the ship instead of a ship mortgage. The fiduciary assignment has a number of benefits in Brazil compared to a ship mortgage. This includes

13 See www.bis.org/bcbs/publ/d299.pdf.

14 See https://www.bis.org/bcbs/implementation/l2_br_followup_march18.pdf.

15 See <https://www.bis.org/bcbs/publ/d420.htm>.

better protection for the security holder in the event of insolvency of the borrower, given that the ship's title is held by the security holder until the discharge of the secured obligations. In an insolvency of the borrower, the ship is not subject to priority rules among the creditors of the borrower. Another benefit of the fiduciary assignment is that the borrower, for not having ownership but only possession of the ship, has no right to dispose of or place an encumbrance on the ship in any form except for maritime liens arising from regular trade.

Finance providers may also require the assignment of the buyer's right under the shipbuilding contract and any associated guarantee or security provided to the buyer for the obligations of the shipbuilder.

As to aircraft financing, only registered aircraft in Brazil are subject to Brazilian mortgages. An aircraft that has never been registered in Brazil may not be subject to a Brazilian mortgage. Brazilian mortgages, after being fully perfected by registration with the RAB, will afford a first priority security interest *in rem* over an aircraft in favour of a mortgagee. Considering the recent accession and ratification of the CTC, there is a lack of precedents in judicial and administrative levels to ensure, at this point, the immediate and literal application of all terms and conditions thereof. However, we are of the view that there are legal grounds to defend that such treaty should prevail, in accordance with its terms and the declarations deposited by Brazil, in respect thereof.¹⁶ After registration with the International Registry, Brazilian mortgages and leases in relation to registered aircraft in Brazil should be effective to create international interests.

ii Enforcement

Generally, Brazilian courts are expected to enforce consensual security interests perfected in accordance with applicable law. State courts have jurisdiction over foreclosure actions based on valid security interests. The usual procedure includes seizure of the collateral, official appraisal and judicial sale of the collateral.

On 18 March 2016, a new Code of Civil Procedure became effective. The statutory changes made through the Code of Civil Procedure are primarily intended to improve the speed and the effectiveness of civil court proceedings. One provision of the Code of Civil Procedure that could be particularly relevant refers to foreclosure actions, which can now be filed directly against the owner of the collateralised asset, and not only against the principal debtor, its assignors or successors, which was required under the revoked Code of Civil Procedure.

The change consolidates an understanding that was already largely accepted by Brazilian scholars and courts. According to such understanding, a beneficiary of a security interest may take action directly against the owner of the property in cases where the principal debtor and the owner are different individuals or entities.

This provision may also be relevant if a collateral is transferred and the relevant secured party needs to enforce its *in rem* rights against the new owner. This is particularly important in relation to Brazilian mortgages, as the principal debtor is not required by law to obtain a consent from the beneficiary of the security interest before transferring title to the collateral. A contractual provision demanding such consent may be held invalid. However, Brazilian law would allow for a provision under the financing documents to establish that a transfer of title without the consent of the security holder represents an event of default.

¹⁶ Please refer to 'Effects of insolvency procedures' in Section IV.ii below for discussion of the application of the CTC in a judicial recuperation scenario.

Ship finance providers in a default or insolvency context will typically consider enforcing mortgagee's rights to secure the payment of the debt. Because self-help remedies are not recognised under Brazilian law, a mortgagee in such a case has to seek court intervention to enforce its rights.

A mortgagee cannot request in court to take possession of a mortgaged ship. Under Brazilian law, the mortgagee's main right is to request the court to seize and auction the mortgaged asset. The security holder of a fiduciary assignment is, however, the legal owner of the collateralised asset and can thus repossess it from a defaulting borrower. Recent practice in insolvency cases has also proven that controlling the movement or effectively taking possession of a collateralised ship in Brazil is often achievable more efficiently by a combination of out-of-court negotiations and other alternatives, such as taking control of the borrower through an existing share pledge.

In a default context involving securities over vessels, maritime liens created by operation of law also have to be considered when assessing the rank of priority of security interests deriving from the finance documentation.

In relation to mortgages over aircraft, in case of an event of default under a Brazilian mortgage, the mortgagee may pursue foreclosure proceeding based on such Brazilian mortgage; however, the mortgagee would not be automatically entitled to seek repossession of an aircraft from a lessee.

Effects of insolvency procedures

In an insolvency context, enforcements depend on the nature of the security interest. Credits secured by fiduciary assignments are generally not subject to effects of judicial recuperation or bankruptcy proceedings. Other securities will be subject to such proceedings and payment of the debts will occur insofar as higher-ranked competing creditors under the Bankruptcy and Restructuring Law (Law 11,101/2005) are paid first in a liquidation proceeding or subject to the judicial recuperation plan. Insolvency contexts also trigger stay periods, in which no legal action can be taken against the debtor to secure payment and hardening periods, which may lead to the invalidation of securities created over debtor's properties prior to bankruptcy.

The Bankruptcy and Restructuring Law allows airlines to avail themselves of insolvency protections roughly similar to the US Chapter 11. Theoretically, the stay period in the Bankruptcy and Restructuring Law is not applicable for aircraft leases. Recently, the application of the stay period for lessors and the CTC have been extensively disputed in the judicial recuperation filed by the airline Oceanair Linhas Aéreas S.A. and AVB Holding S.A. (trading as Avianca in Brazil) in state courts of São Paulo. The trial court judge ordered the suspension of all repossession actions filed by lessors, as well as de-registration requests addressed to ANAC. Although the judge recognised that aircraft leases are not subject to judicial recuperations and the applicability of the CTC, he ordered the suspension on the basis that allowing repossession of several aircraft would make a restructuring unfeasible. Initially, the suspension should apply for 30 days, based on the stay period mentioned in the CTC. After expiry of the initial 30-day term, the court extended the suspension on the principle-based argument that the provisions of the Bankruptcy and Restructuring Law and the CTC allowing lessors to repossess and export their equipment following a default should be mitigated because they are the most essential assets to an airline and the purpose of the Bankruptcy and Restructure Law is to allow the maintenance of business ventures. Lessors

and ANAC have appealed the trial court decision. As of February 2019, the issue is waiting to be decided by the São Paulo Court of Appeals and the Superior Court of Justice in different appeals.

iii Arrest and judicial sale

Brazil has not ratified the Conventions on the Arrest of Ships of 1952 and 1999. Ships can generally be arrested on the basis of the Brazilian Commercial Code and the Brazilian Civil Procedure Code. Arrest can also occur on the basis of the 1926 Brussels Convention, the Bustamante Code, the International Convention on Civil Liability for Oil Pollution Damage and the Assistance and Salvage Law (Law 7,203/84).

Under Brazilian law, there is one category of maritime claim that can be brought by way of arrest of a ship. This category is described in the Brazilian Commercial Code and provides that as long as maritime privileged credits existing against the ship continue to exist (the law actually refers to 'privileged' claims), the arrest may be granted. Privileged obligations have *in rem* effects and constitute a maritime lien over the ship.

The list of maritime privileged credits that gives rise to a maritime lien on the vessel includes mortgagee's rights. The entire list is found in the Brazilian Commercial Code and is amended and complemented by the 1926 Brussels Convention.

In addition to maritime liens, which is the main category that can give rise to the arrest of a vessel, there is a second type of claim that might cause the start of a judicial arrest of the vessel not as consequence of an *in rem* obligation but as a consequence of an *in personam* obligation.

By way of a right of attachment, the Code of Civil Procedure allows a party to seek conservatory detention of the vessel through an *ex parte* order seizing a vessel based on elements capable of proving the probability of the alleged claim (*fumus boni iuris*) and the risk of loss or damages to the useful outcome of the lawsuit (*periculum in mora*).

The arrest, or embargo, of a ship is a provisional remedy in Brazil, adopted to secure an underlying claim that is subject to the Brazilian jurisdiction. Generally, a claim is subject to the Brazilian jurisdiction if the defendant is domiciled in Brazil, if the obligation is performed in Brazil, or if the event giving rise to the claim has taken place in Brazil.

The arrest of a ship based on a foreign decision or arbitral award is also permitted. If the arrest order is granted as an urgent interlocutory decision, according to the Code of Civil Procedure, the arrest order would be recognised and accepted by Brazilian courts without examination of the merits upon ratification by the Superior Court of Justice.

The condition to ratify an urgent interlocutory decision is that:

- a it must comply with formalities necessary for its enforcement under the laws of the place where it was rendered;
- b it must have been given by a competent court after proper service of process on the parties or after sufficient evidence of the parties' absence, as established pursuant to applicable law;
- c it must not be contrary to Brazilian sovereignty, public policy and good morals;
- d it must be duly apostilled pursuant to the Hague Apostille Convention or authenticated by the competent Brazilian consulate and be accompanied by a sworn translation into the Portuguese language; and
- e it must not be a decision on any matter over which the Brazilian Judiciary has exclusive jurisdiction.

If it becomes necessary to enforce in Brazil a foreign decision or arbitral award that is final and on the merits of the dispute, the party seeking the enforcement must first ratify the decision with the Superior Court of Justice to confirm that the requirements (a) to (e) above have been met, in addition to demonstrating that the decision may not be subject to appeal. Again, no examination of the merits is made. Brazil has ratified the 1958 New York Convention.

Ships can be arrested in Brazil under *in rem* or *in personam* claims. Claims *in rem* are possible when the creditor has a proprietary security interest over the ship. Claims *in personam*, on the other hand, refer to credits that the arrestor has against the shipowner and not the ship.

Under *in personam* claims, the arrestor is required to prove with a certain degree of certainty not only its credit in respect of the vessel owner, but also the risk of the frustration of its claim if the arrest is not granted. Typically, the risk of frustration is demonstrated when the vessel that is subject to the arrest proceeding is the only asset of the shipowner and no court bond is provided by the shipowner to secure the claim.

In the case of an *in rem* claim, on the other hand, it is not required that the arrestor demonstrates the risk of frustration. It should suffice to prove the mere existence of a maritime lien. Maritime liens include a consensual security interest, originating, for instance, from a mortgage instrument, and a non-consensual security interest, secured to its holder through an *ex lege* lien such as seamen's wages, bunker or port duties.

A foreign-domiciled arrestor with no assets in Brazil is further required to secure the payment of judicial costs and attorneys' fees corresponding to 10–20 per cent of the claim value, except if there is an applicable international treaty waiving such requirement. Additionally, a counter-guarantee may be requested in very exceptional cases, at the judge's discretion, to grant the arrest order. The amount of the counter-guarantee is generally set at 20 per cent or more over the amount of the debt in dispute. Any guarantee must be posted either in cash, bank guarantee, insurance bond or other collateral acceptable to the court. Generally, when dealing with foreign plaintiffs, courts are likely to require cash and bank guarantees.

While Brazil does not have specific legislation on wrongful arrests, a separate civil claim can be brought in tort by an arrested party against a wrongful arrestor. In such cases, the arrested party has to prove not only the damage and causation but that the wrongful arrestor acted with negligence in arresting the vessel.

The arrested party must also demonstrate that the wrongful arrestor acted in bad faith (e.g., by using false pretences or unsupported facts) when bringing the arrest proceeding. The arrested party in such a claim may seek compensation for actual damages and payment of a penalty for bad-faith litigation ranging from 1–10 per cent of the updated claim value.

As for the arrest of a sister ship or associated arrests, Brazil does not have legislation allowing these based on a maritime lien. The alternative in such cases is to enforce a right of attachment, which is an action *in personam* against the shipowner, and seize the sister ship to secure the main claim.

Judicial sale

The judicial sales of assets can follow three different proceedings in Brazil:

- a Adjudication (award) – the creditor (including secured creditors) is authorised to request the award of the asset, which transfers the title to the creditor, provided that the creditor offers an amount not lower than the value indicated in the official appraisal of the asset.

- b Court-regulated private sale – the creditor can procure the sale of the asset by him or herself or through a broker registered with the court upon the judge’s authorisation. The judge shall have determined all the minimum requirements (i.e., minimum price, payment method, guarantees, publicity method, etc.), following a very similar procedure to that of the public auction.
- c Public auction – this is the most common method used for an asset sale. The proceeding requires the publication of an advisory notice at least five days before the auction date to inform possible interested purchasers. In view of the Code of Civil Procedure provisions, it is preferred that the auction be made online, although the court may decide in a particular case that the physical auction is more adequate. The valuation of the asset is made through an official appraisal and the court has discretionary powers to set the minimum sale price. The amount of the valuation and the minimum sale price must be included in the advisory notice of the auction. If the court does not set the minimum sale price, the minimum sale price will be no less than 50 per cent of the amount of the valuation.

In cases contemplated by law and when the assets deposited in court are subject to quick deterioration or require high custody costs, the judge can order an anticipated sale of the asset by auction. Additionally, the judicial costs involved in the legal foreclosure proceeding takes precedence over all privileged credits.

If the sale is completed through the adjudication method, the procedure may be concluded in a relatively short period (around one to three months). Any of other two methods rarely takes less than six months to a year.

Governing law

Brazilian law governs arrests and judicial sales procedures of assets carried out in Brazil.

V CURRENT DEVELOPMENTS

i Recent cases

A recent case concerns the recognition and enforceability in Brazil of a Liberian mortgage over a Liberian-flagged floating production, storage and offloading unit (FPSO). The first-instance decision in São Paulo did not recognise a Liberian law mortgage and denied the mortgagee’s right of priority against a creditor arresting the FPSO on the basis of an *in personam* obligation (a defaulted letter of credit). The mortgagee in this particular case is a bond trustee. The trial court judge held that the mortgage should be registered with the Brazilian Maritime Tribunal to be recognised in Brazil.

In February 2016, the São Paulo Court of Appeals upheld the decision of not recognising the mortgage based, among others, on the fact that Liberia is not a party to the 1926 Brussels Convention or to the Bustamante Code, which, according to the decision, are the only pieces of legislation allowing the recognition of a foreign mortgage in Brazil.

On 16 November 2017, the Superior Court of Justice granted the Special Appeal filed by the mortgagee and recognised the effectiveness of foreign law mortgages. The Court held that: (1) the 1926 Brussels Convention and the Bustamante Code are valid and effective in Brazil with the same hierarchy of ordinary federal laws; (2) such international conventions provide for the general recognition of maritime mortgages governed by foreign laws; (3) the United Nations Convention on the Law of the Sea allows flag states to exercise their sovereign

powers to set forth administrative and technical rules applicable to vessels flying their flags; and (4) the registration of the mortgage with the proper registry at the flag state is sufficient to give public notice of the lien over the vessel.

Additionally, the Court acknowledged the economic convenience for jurisdictions to recognise foreign mortgages, on the basis that shipbuilders, shipowners and financiers need a safe and predictable economic environment to invest and carry on their business. Although this precedent is not automatically binding to future disputes, it is extremely persuasive.

As well as the above case involving the recognition of a foreign mortgage, there has been a recent case concerning a mortgagee's request to arrest a ship simultaneously with the arrest of the same ship by another creditor. In the case, both the trial court and appeals court denied the pleadings of certain creditors to join an arrest proceeding under which the arrest order had already been granted to another creditor. The case illustrates that an arrest order granted in favour of a certain creditor does not benefit a mortgagee nor any other party with interests over the asset.

ii Developments in policy and legislation

In terms of aviation regulation, in June 2015, the Brazilian Senate formed a commission to draft a bill to replace the Brazilian Aeronautical Code (the Code). The intention is to enact a more modern Code, as the existing one dates back to 1986. In April 2016, the commission presented the final draft¹⁷ and it was approved by a special commission of the Congress in November 2018. The draft now awaits voting by the plenary during the course of 2019.¹⁸ Although the draft bill remains subject to further discussions and possible changes in the Brazilian House of Representatives and the Brazilian Senate, there are some relevant proposals that we believe are important to consider.

The bill will include an express reference to aircraft engines in the section that deals with mortgages. At present the current Code has only a broad reference to aircraft mortgages without any express reference to engines. Additionally, engines do not have separate registration in Brazil. The change to expressly include engines will essentially reaffirm existing practice in Brazil, as the Brazilian civil aviation authority, the National Civil Aviation Agency (ANAC) does accept mortgages and other agreements (e.g., leases) in relation to engines, regardless of the lack of any express reference in the Code.

In 2018, the Brazilian federal government announced that at least 13 airports would be privatised in the first quarter of 2019.¹⁹ The winning bidders will have five years to make improvements in the airport structure, following the ANAC recommendations. In 2017, ANAC issued Resolution No. 400 imposing new rules for air transport contracts between airline operators and consumers, changing the rules related to the possibility of charging for luggage, ticket refunds and information to be listed in airline tickets.²⁰

17 See <https://www12.senado.leg.br/noticias/materias/2016/04/15/comissao-conclui-Atualizacao-do-codigo-brasileiro-de-aeronautica>.

18 See <https://www12.senado.leg.br/noticias/materias/2018/11/07/aprovado-em-comissao-novo-codigo-brasileiro-de-aeronautica-vai-para-o-plenario>.

19 See <https://g1.globo.com/economia/noticia/governo-divulga-calendario-de-licitacoes-para-concessao-de-13-aeropostos.ghtml>.

20 According to the Resolution, each company can have their own rules and fees to transporting luggage, which may vary between airline operators and were presented in the beginning of 2019 to the consumers.

CANADA

*Damon Chisholm, Joanna Dawson, Ryan Gallagher and Lucia Stuhldreier*¹

I INTRODUCTION

Canadian transportation policy is continuously evolving as a response to provide a more competitive regime to attract new business while balancing other interests, such as environmental issues. Although Canada is bordered by three oceans, the majority of trade moves by rail and not by sea. Canada's ports and harbours, railways and airports provide integral transportation to domestic and international economic activities. Canada's marine industry comprises a number of domestic marine service operators that provide shipping services both domestically and internationally.

II LEGISLATIVE FRAMEWORK

Domestic and international law and regulation

Aviation

Civil aircraft in Canada are registered under Part II of the Canadian Aviation Regulations, under the laws of a Member State of the International Civil Aviation Organization, or under the laws of a state with a bilateral agreement allowing for flights into Canada. Canada's civil aircraft registry does not keep track of title to aircraft, but instead involves registration based on custody and control of aircraft. Basing registration on custody and control means that Canadian aircraft may be registered to a lessee who is responsible for ongoing operation and maintenance, even though the lessor holds title to the aircraft. This can lead to problems for the registration of security interests in aircraft, as there is no registry for title of or liens registered against aircraft. For these reasons, aircraft security interests in Canada are governed by provincial personal property security legislation.

Canada signed the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters specific to Aircraft Equipment (the Cape Town Convention) in 2004, and passed federal legislation in 2013² ratifying the Cape Town Convention. The Cape Town Convention facilitates asset-based financing by creating an international legal framework concerning the creation and enforcement of security interests in aircraft equipment, thus alleviating the previous concerns with the Canadian regulatory regime.

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2 The International Interests in Mobile Equipment (Aircraft Equipment) Act.

The Cape Town Convention establishes uniform criteria for creating international interests (such as security agreements) in aircraft equipment, an electronic international registry with first-to-file priority, a system of default remedies available to creditors, and possession rights for debtors. During the process of ratification, a country can make certain declarations that outline, *inter alia*, specific remedies and insolvency rights.

Marine

Because of the division of powers set out in the Canadian Constitution, maritime law is subject to both provincial and federal legislation. The federal government has been granted exclusive jurisdiction over navigation and shipping and various other related marine matters. However, each province has been granted jurisdiction over property in the province. International maritime conventions are also recognised as a source of law and are effected in both case law and statute. The provincial superior courts have inherent jurisdiction over all matters, unless such jurisdiction is expressly excluded, and the Federal Court of Canada has concurrent jurisdiction to hear specific matters granted in respect of Canadian maritime law.

Vessel financing may be secured by the registration of a statutory mortgage governed by the federal Canada Shipping Act 2001 (CSA), by provincial personal property security legislation, or by both, depending on the type of vessel and the security to be taken. However, many of the provinces have legislation that specifically provides that mortgages under the CSA are exempt from the provincial personal property security regime.

The CSA statutory system of registration for ship mortgages applies only to vessels that are registered or recorded in the Canadian Register. The CSA mandates that a vessel, unless it qualifies for an exemption under the regulations, must be registered under the CSA if it is not a pleasure craft, is wholly owned by qualified persons, and is not registered, listed or otherwise recorded in a foreign state. While registration of pleasure craft is optional, it may be advisable as vessel financing security provided under the CSA does not extend to non-registered vessels. A vessel that is under construction in Canada may be temporarily recorded as a vessel being built in Canada.

Rail

As a general rule, under the constitutional division of powers, railways that cross provincial borders or international boundaries are subject to federal jurisdiction; those located entirely within a province are provincially regulated. Financial transactions involving federally regulated railway companies,³ such as mortgages and financings of rolling stock,⁴ are governed by the Canada Transportation Act (CTA). Part III, Division 3 of the CTA creates a regime governing the registration of financing documents by both railway companies and owners of rolling stock. Additionally, provincial real and personal property legislation can apply to railway assets, so many parties elect to make registrations in provincial personal property registries and real property title offices in conjunction with their CTA registration.

3 A 'railway company' is defined in Section 87 to refer to: a person who holds a certificate of fitness under Section 92, a partnership of such persons or a person who is mentioned in Subsection 90(2).

4 Definition of 'rolling stock' in the Canada Transportation Act, Section 6, is as follows: a locomotive, engine, motor car, tender, snow-plough, flanger and any car or railway equipment that is designed for movement on its wheels on the rails of a railway.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The Bank Act (Canada), and the numerous corresponding regulations, provide the primary framework over all banking activity in Canada. Pursuant to the Bank Act, banks must maintain adequate and appropriate forms of liquidity. In addition, the Office of the Superintendent of Financial Institutions (OSFI) may make guidelines respecting adequate and appropriate forms of liquidity.

In July 2018, OSFI issued a discussion paper setting out OSFI's proposed policy direction and timelines for implementing the final Basel III reforms in Canada, which include changes to the credit risk, operational risk, leverage ratio and credit valuation adjustment frameworks as well as to the capital floor. OSFI has noted its support for the changes proposed in the final Basel III reforms and intends to implement them domestically while also being guided by the unique characteristics of the Canadian market. Although, given the substantial amount of revisions to the capital framework that are required to reflect the final Basel III reforms, OSFI is considering staggering the implementation of certain standards over a period of time. Industry feedback on these changes is being sought through a separate consultation process.

ii Supervisory regime

Canada has a shared system of financial regulation and supervision between the Minister of Finance and the federal and provincial governing bodies. However, the Minister of Finance has ultimate responsibility for the oversight of Canada's financial system.

The supervision of all banks in Canada, federally registered trust and loan companies, insurance companies, cooperative credit associations and private pension plans is conducted by the OSFI, which is an independent government agency responsible for the administration of the Bank Act (Canada) and overseeing banks under the supervision of the Minister of Finance. The Financial Transactions and Reports Analysis Centre of Canada is responsible for anti-money laundering and anti-terrorist-financing monitoring. The Financial Consumer Agency of Canada administers the consumer provisions of the Bank Act, which include disclosure requirements respecting borrowing costs and deposit account terms. The activities of banks in Canada are also subject to the federal system of deposit insurance operated by the Canada Deposit Insurance Corporation.

At the provincial level, authorities regulate credit unions and *caisses populaires* (in Quebec), and securities commissions administer and enforce securities legislation and regulate all securities-related activities within the province.

The Bank of Canada is the nation's central bank. The Bank of Canada regulates the nation's credit and currency and generally promotes the economic and financial welfare of Canada.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

Aircraft

Aircraft objects are primarily financed through leases, secured loans, chattel mortgages, and conditional or instalment sales. Those who have legal custody and control over an aircraft, as opposed to the registered owner, have complete responsibility for the operation and maintenance of the aircraft and must file evidence of this responsibility with Transport Canada

in the Canadian Civil Aircraft Register (CCAR). Lease interests must also be registered with the CCAR, although the register is not a register of title or liens related to aircraft. An aircraft registered in the CCAR may be removed through a process known as de-registration in the event that legal custody and control over the relevant aircraft is transferred.

Security interests in aircraft are governed by provincial laws as opposed to those at the federal level. A movable hypothec will be required to create a security interest over an aircraft in Quebec, while in other Canadian provinces a security agreement will typically be sufficient for the purposes of creating and registering a security interest. To perfect a security interest after 1 April 2013 for aircraft meeting the requirements of the Cape Town Convention, security interests must be registered in the International Registry. It remains common practice to also register a security interest in the relevant provincial register for personal property security. An International Registry registration of a fully and properly constituted international interest in an aircraft object will have priority over all provincial registrations made after 1 April 2013. There are, however, limited exceptions to preserve the priority of non-consensual rights of third parties in Canada.

Marine

The most common method of financing vessels is through a mortgage pursuant to the CSA. However, as movable personal property, vessels are also subject to provincial personal property security legislation. The appropriate statutory regime is determined by the vessel category and the nature of collateral. When there is direct conflict between federal and provincial legislation, the doctrine of paramountcy dictates that federal regulation will take primacy. The interaction between provincial personal property regimes and federal jurisdiction over vessels has not been definitely resolved, and thus care must be taken to determine which statutory scheme governs.

The CSA allows the registered owner of a registered vessel to grant a mortgage against a vessel, or any share of it, as security for any financing. In addition to the statutory form, parties usually elect to enter into a collateral agreement outlining the full obligations and rights and remedies of the mortgage. The mortgagor will generally be required to, *inter alia*, pay the principal and interest on schedule, maintain and operate the vessel appropriately, and maintain insurance for the vessel. In the case where a mortgagee is entering into a subsequent mortgage, the loan may also involve higher interest to offset the increased risk associated with being a subordinate mortgagee. Mortgagors have a multitude of rights under the mortgage, including the right to sell the ship (assuming this is not explicitly excluded as a possibility in the agreement); however, the mortgagor must not materially impair the mortgage security.

As there are no provisions for taking a mortgage under the CSA over a licensed pleasure craft or a vessel registered in the small vessel register, the vessel is treated as 'personal property' and may be charged by any methods recognised by law for the taking of security in chattel or personal property (i.e., provincial personal property security legislation). In general, lenders (particularly financial institutions) are reluctant to provide financing unless the vessel is registered under the CSA.

The CSA also allows for the registration of a mortgage against a vessel in the process of being built. A builder's mortgage operates in a similar manner as if it were a mortgage of a registered vessel, although it is common practice that this is discharged upon completion of the construction and subsequently replaced with a standard mortgage.

The CSA augments the security of a mortgage to the extent that it provides a statutory scheme of registration whereby the mortgagee can give notice that it has an interest in and

over a particular vessel. However, a statutory mortgage does not afford creditors complete security for repayment of indebtedness, as vessels may move to jurisdictions or ports where courts do not enforce Canadian mortgages. In addition, other unregistered maritime or statutory liens may take priority over the registered mortgage, which leads creditors to seek additional protection, such as the right to proceeds of insurance policies or a charge on the vessel's freight.

Under the CSA, no charges other than a mortgage are registrable; thus, searches may be used to determine the owner and statutory mortgages registered against a particular ship but will fail to reveal any other encumbrances on the ship, particularly maritime liens that are not registrable. In addition, failure to register the mortgage under the CSA can result in a loss of priority.

The Bank Act also allows a bank to register security in fishing vessels and aquaculturists' vessels with the Bank of Canada. Under the Bank Act, the secured party only needs to provide notice of intention to take a security interest. In competition between a Bank Act security and a mortgage, priority will be determined based on the first to register under the CSA. To avoid this disadvantage, a fishing vessel (but not an aquaculturists' vessel) can be registered under both the CSA and the Bank Act, which allows banks to have the additional protection of the CSA in priority disputes.

Rail

Section 104 of the CTA allows any person to deposit in the office of the Registrar General of Canada (the Registrar) a mortgage or hypothec issued by a railway company, a security agreement entered by a railway company, an assignment or other document relating to the foregoing, or copies or summaries of any such documents. Similarly, Section 105 of the CTA allows any person to deposit in the office of the Registrar documents, or copies or summaries of security documents, relating to rolling stock, including those evidencing a lease, sale, mortgage, hypothec, security agreement, and various other types of transactions.

The office of the Registrar has established a registry system (the Registry) for security documents relating to railway assets under Sections 104 and 105 of the CTA. The Registry receives documents electronically and makes such documents available online in a publicly available and searchable database. The Registry is intended to provide public notice of the interests established in the documents deposited. Filings under Sections 104 and 105 of the CTA are optional. The Registry is not self-expunging; an interest will remain in the registry indefinitely, and therefore give notice to third parties, until it is expressly amended or discharged by filing of a subsequent document.

When searching the Registry, the searcher should input the name of the current owner or obligor, as well as previous owners or obligors (and any known predecessors to each), as applicable, of the property or rolling stock to be searched. When searching rolling stock, it may be advisable to also search by the rolling stock UMLER marks assigned by the Association of American Railroads. The Registry does not purport to be a title or ownership registry and no provincial or federal ownership registry exists for rolling stock.

Parties often choose to file memoranda or summaries of documents, so it may be necessary to attempt to contact one or more parties for further information. One may need to review many documents to assess the extent to which a particular asset is subject to a security interest. Further, because there is no requirement to file a security interest in the Registry, subsequent documents that affect the interest may not be available in the Registry. Accordingly, the results of searches of the Registry may bear some risk.

Provincial legislation may also apply to certain railway assets. Parties may elect to file security interests in real and personal property registries established under provincial legislation in addition to the Registry, or instead of the Registry, depending on the asset. As a result, it is generally advisable for a party seeking to take a security interest in a railway asset to search the Registry as well as potentially applicable provincial registries.

ii Enforcement

Aircraft

With the adoption of the Cape Town Convention, repossession of an aircraft upon default may be conducted subject to the applicable lease or security agreement. This includes repossession pursuant to foreign law as chosen by parties to the contract, so long as the choice to implement this foreign law was made *bona fide*. Federally governed insolvency law, as outlined in the BIA and the CCAA, is also applicable to aircraft contracts.

A creditor can enforce its rights under a lease agreement even in the event that the lease has not yet been terminated, so long as an event of default occurs. The common law provinces of Canada allow for self-help remedies in events of default under a lease agreement. In Quebec, enforcement originally must have been authorised by a court; however, this requirement has been modified since the coming in force of the Cape Town Convention, which allows for self-help remedies in the event of default under a lease agreement. Although the Cape Town Convention allows for self-help remedies, they have yet to be judicially considered in Quebec.

Injunctions are another effective, albeit costly and time-consuming, enforcement mechanism. They are particularly useful in situations where delivery of the aircraft would be challenging.

Marine

Mortgages must be recorded in the order in which they are filed with the Vessel Registry. The priority of competing mortgages in respect of the same vessel or share in a vessel is determined by the sequence of the registration of the mortgages and not according to date of each mortgage, unless all of the mortgagees file their written consent with the Chief Registrar.

If seeking to enforce under a marine mortgage, the mortgagee has the right to take possession of and sell the vessel in circumstances of default or material impairment of the mortgagee's security by the mortgagor. Circumstances of default are generally defined in the loan agreement, in which case the mortgagee will often be able to take possession of the vessel in realisation of its security interest. Material impairment of the mortgagee's security is a question of fact, generally established when there is a material effect on the value of the vessel or the other property subject to the mortgage. Once material impairment is established, the mortgagee can take possession of the vessel and can treat the mortgage agreement as having been repudiated such that the contract is enforceable against the mortgagor for breach of contract but unenforceable against the mortgagee.

Possession by the mortgagee can take the form of actual possession or constructive possession, with constructive possession involving the establishment of a clear intention to take ownership of the vessel. Once the mortgagee is in possession, the mortgagee has all of the rights and obligations of ownership, including expenses associated with the vessel, and can make use of the vessel subject to the terms of the mortgage.

Upon default by the mortgagor, the mortgagee obtains an absolute power of sale. Up to the point of sale, the mortgagee has an obligation to exercise appropriate care of the ship and

sell the vessel in good faith and at the best price possible. Sale can be conducted as either a personal sale or a judicial sale. When conducting a personal sale, the mortgagee will generally issue a statutory bill of sale such that the purchaser can maintain the vessel on the registry. Personal sale is a less costly and more time-efficient method than court-administered sale; however, the mortgagee will only be able to transfer as much good title to the purchaser as the mortgagee has itself.

However, if there is more than one registered mortgage of the same vessel or share, a subsequent mortgagee may not, except under court order of competent jurisdiction, sell the vessel or share without the agreement of every prior mortgagee.

Under the Bank Act, a bank's security interest will grant it the statutory power of seizure and sale upon default. The bank's power of sale in circumstances of default grants it the ability to conduct a sale by public auction, while the right of sale in other circumstance will be subject to the terms of the agreement entered into with the borrower. The bank has an obligation to provide notice of sale, act with expediency, and act in a commercially reasonable manner.

iii Arrest and judicial sale

Aircraft

With regard to international interests, the Cape Town Convention provides multiple remedies that can be exercised with or without the intervention of courts, so long as they are exercised in a commercially reasonable manner. These remedies include allowing a creditor to: (1) take possession or control of the aircraft; (2) sell or lease the aircraft; or (3) collect or receive income or profit arising from the use of the aircraft. The enforcement of foreign judgments is determined at the provincial level, and Canadian courts will generally enforce a judgment of a foreign jurisdiction for a sum certain that is a final non-appealable judgment issued by a court of competent jurisdiction.

Under non-international security interests, a secured creditor will typically apply to the court to obtain repossession of the aircraft. Creditors can only exercise self-help remedies if they are provided for in the security agreement and do not involve the use of excessive force. An order of surrender can be obtained within a few weeks in the event that the repossession is not opposed. If the matter requires trial, it may take one or two years for the order of surrender to be obtained, and this may take even longer if the trial is appealed. When a repossession is opposed, the law allows for provisional grounding measures. For example, common-law provinces allow for an interim recovery judgment. Additional measures are also available; for instance, an interlocutory injunction may be awarded to a creditor pending trial, so long as there is a risk of unlawful removal of the aircraft from the province.

Canada's adoption of the Cape Town Convention allows a lessee or debtor who seeks protection from its creditors under Canadian insolvency law to be granted a stay of up to 60 days prior to the lessor or secured creditor being entitled to seize the aircraft. The lessee or debtor will not be able to avoid the seizure unless it remedies all prior defaults and agrees to continue performing its obligations both during and after the insolvency proceedings.

Marine

One method of sale available to marine mortgagees is to arrest the ship and conduct an *in rem* judicial sale. Unlike personal sale, this allows the mortgagee to clear title on the vessel, so this is the preferred method of sale if there are multiple charges on the vessel or when multiple parties hold an interest in the vessel. In conducting a judicial sale, the mortgagee also has

the option to obtain an *in personam* judgment against the mortgagor's other assets. As is the case with personal sales, either the mortgagee or the marshal will issue a bill of sale to the purchaser such that the purchaser can maintain the vessel on the registry. When a vessel is subject to several security interests, maritime liens will have a priority ranking above statutory mortgages.

V CURRENT DEVELOPMENTS

i Developments in policy and legislation

Marine

The Canadian shipping industry is frequently subject to changing legislation and policy, domestically and internationally, which can affect compliance with vessel security, thus increasing the costs to the vessel owner. In Canada, much of the recent initiatives are focused on environmental issues. For example, the new Arctic Shipping Safety and Pollution Prevention Regulations, which incorporate the International Code for Ships Operating in Polar Waters, include several safety and pollution prevention measures relating to vessel design and equipment, vessel operations and crew training.

The Canada-European Union (EU) Comprehensive Economic and Trade Agreement brings changes to coasting trade rules that apply to the use of foreign vessels. EU owners of eligible vessels may obtain a limited number of coasting trade services without a licence upon acceptance of advance notification by the Canada Border Services Agency.

ii Trends and outlook for the future

Canada has contributed significant resources to the environmental assessment of its coastlines. Under the Oceans Protection Plan, the government is currently assessing the environmental impact on marine shipping, which includes numerous environmental and economic considerations.

CHINA

Wang Shu, Zhu Jun, Ren Jiyu and Qin Wei¹

I INTRODUCTION

i The transport finance industry

The transport finance industry is a fast-growing business in China mainly because the transportation industry in China experienced rapid growth and expansion in recent years during the urbanisation of the country and the modernisation of China's transport infrastructure.

Aviation

China's civil aviation market is one of the most important and rapidly growing aviation markets in the world. According to the data published by the Civil Aviation Administration of China (CAAC) and China Aviation News, during the period from January to December of 2018, the operating income of China's civil aviation industry was 875 billion yuan, an increase of 17 per cent from the same period of the previous year. China's airlines have imported 426 commercial aircraft in 2018, and the entire Chinese commercial aircraft fleet has reached 3,615 aircraft.

The civil aviation finance industry in China is also growing rapidly in line with the expansion of the Chinese commercial aircraft fleet. While the industry used to be dominated by foreign lessors and commercial banks, more and more domestic lessors and investors have started their aircraft finance business and are expanding their business quickly, mostly by using Chinese tax-bonded area leasing and financing structures. Because of the fluctuation in the exchange rate of the yuan since 2015, while US-dollar financing is still prevailing in the operating lease market, yuan financing has dominated the financing lease market for Chinese airlines' acquisition of aircraft. A number of Chinese lessors have built up their offshore aircraft fleet as well and have extended their business to the Middle East, South Asia, South America and Europe. A large amount of Chinese funds flowed into the overseas aviation market.

Shipping

China plays an important role in the world's shipping industry in terms of its ship-building and water transportation capacities. According to data published by the China Association of the National Shipbuilding Industry, during the period from January to November of 2018, there were 1,212 national shipbuilding enterprises with prime operating revenue of

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403.22 billion yuan, a decrease of 31.7 per cent from the same period last year. In 2018, China's completed tonnage is 34.58 million and the new order tonnage is 36.67 million, representing 43.2 per cent and 43.9 per cent of the global market share.

Despite the downturn of the shipping market after the financial crisis in 2008, certain Chinese lenders have continued to be active in ship financing. The leading banks that provide shipping finance include the Bank of China, the Export-Import Bank of China and the China Development Bank. More and more financial leasing companies also participated in the shipping finance industry through financial leases and bareboat charters.

Rail

Because of its importance in China's economy, China's rail industry is highly controlled and influenced by the state. Before 2013, most of China's rail assets were directly owned and operated by the Ministry of Railways and its local bureaus. After 2013, China established the China Railway Corporation (CRC), which is one of the largest state-owned companies in China, to own and operate China's rail assets. After the establishment of the CRC, the Ministry of Railways was dissolved and incorporated into the Ministry of Transportation.

Because of the CRC's dominant position in the industry, the finance of rail equipment is mainly through the CRC's bank lending, bond issuance and financial leases. The state also encourages private capital to invest in the railway sector, especially for the construction and operation of intercity railways, urban (suburban) railways, railways designed for resource development and branch railways.² The railway construction bonds, asset-backed securities and public-private-partnership model, which are very popular in China to attract private capital in infrastructure industry, have also been or encouraged to be adopted in the rail industry. In 2018, the total investment in fixed assets of the railway in China exceeded 802.8 billion yuan.

ii Recent changes

China has boosted bank credits, cut taxes and embarked on a massive infrastructure spending programme in an effort to mitigate the adverse effects of the financial crisis in 2008 and the slowdown of the world economy. These stimuli extend to the transport industry as well, and it is expected that during the period from 2016 to 2020, China will invest 15 trillion yuan in the transport sector (which includes 3.5 trillion yuan in rail transportation, 7.8 trillion yuan in road transportation, 65 billion yuan in civil aviation and 5 billion in water transportation).

The main transport financiers in the China market include: (1) the four big state-owned commercial banks, which are the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, and the Agricultural Bank of China; (2) the policy banks, which include the China Development Bank, and the Export-Import Bank of China; (3) certain large commercial banks focusing on the transport section, such as the Bank of Communications; (4) the financial leasing companies and the domestic and foreign-invested leasing companies; and (5) the foreign banks that specialise in the transport finance sector.

The noteworthy changes in China's transport finance sector in the past five years include: (1) the fast growth of China's leasing industry and the rise of Chinese leasing companies

2 The NDRC, the Ministry of Treasury, the CBRC and other authorities, Fa Gai Ji Chu [2015] No. 1610, the Implementing Opinions on Encouraging and Expanding the Investment of Private Capital in the Construction of Railways.

acting as lessors; (2) the reform of China's value-added tax system and after the reform, China lessees are permitted to deduct their value-added taxes paid for capital expenditures; and (3) the establishment of a number of tax-bonded areas and free trade zones and these areas and zones help to create Chinese tax-bonded lease structures for aircraft and ship finance.

In the Boao Forum for Asia Annual Conference held in April 2018, Yi Gang, the president of the People's Bank of China (PBOC), declared some new measures to be taken in respect of the opening-up of the financial field. Up to now, restrictions on foreign shareholding in Chinese-funded banks and financial asset management companies have been removed. In the near future, foreign investment will be encouraged in the financial leasing area and the business scope of foreign-invested banks will be significantly expanded.

Besides which, the National Development and Reform Commission (NDRC) and Ministry of Commerce of China (MOFCOM) promulgated the Special Administrative Measures for Access of Foreign Investment (Negative List) (2018 Edition) on 28 June 2018, according to which, the design, manufacturing and maintenance of aircraft for trunk and tributary lines, the construction and operation of the network of trunk railway lines, the design, manufacturing and repair of vessels (including sections) and the railway passenger transport companies have been removed from the catalogue of restricted foreign investment industries that shall be undertaken by companies controlled by the Chinese party. Therefore, opening-up of the transport finance area is also expected to be a trend in the next few years in China.

II LEGISLATIVE FRAMEWORK

In China, the sources of laws that may affect transport finance include:

- a* the laws made by the National People's Congress (NPC) and its Standing Committee;
- b* the administrative regulations made by the State Council;
- c* the administrative rules made by the ministries, commissions and departments of the State Council;
- d* the local regulations and autonomous regulations made by the local people's congresses and their respective standing committees;
- e* the local administrative rules made by the local governments;
- f* the judicial interpretations to the relevant laws made by the Supreme People's Court of China; and
- g* the international treaties and conventions approved by the NPC and its Standing Committee.

For transport finance transactions that do not involve foreign parties, the legal documentation has to be governed by Chinese law. For the cross-border transport finance transaction, the parties are allowed to select the governing law of the documentation they prefer, and the laws of England and New York are usually preferred by the financiers.

On 28 October 2008, China ratified the Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Protocol. According to China's declarations, the Cape Town Convention does not apply to Hong Kong SAR and Macao SAR. To implement the Cape Town Convention, in 2009, the CAAC issued the Measures on Regulation of Applications for Authorisation Codes for Registrations with the International Registry and the Administrative Procedures for the De-registration of Nationality of Civil Aircraft according to an IDERA.

The Financial Leasing Committee of China Banking Association recently issued the Self-disciplinary Convention on Financial Leasing, which applies to all 61 financial leasing company members of the Financial Leasing Committee and is the first self-disciplinary convention in the financial leasing area. According to this convention, the members are encouraged to gradually lower the business share of sales and leaseback transactions to better serve the real economy.

i Domestic and international law and regulation

China's transport industry is regulated by different regulatory agencies, which include:

- a* the CAAC for civil aviation;
- b* the National Railway Administration of China for railway transportation;
- c* the Water Transportation Agency under the Ministry of Transportation for domestic water transportation; and
- d* the Maritime Safety Administration (MSA) of China for maritime transportation.

Aviation

In China, the nationality, ownership, mortgage rights, priority rights and leasehold interest and airworthiness management in respect of China-registered civil aircraft and the Chinese civil aviation industry are governed by the Civil Aviation Law of China (the Civil Aviation Law) and the administrative rules and orders issued by the State Council and the CAAC.

The CAAC maintains a civil aircraft nationality register (CAAC Nationality Register) and a civil aircraft rights register (CAAC Rights Register). The CAAC Nationality Register is an operator-based register and is now operated by the Airworthiness Department of the CAAC. The CAAC Rights Register is now operated by the China Academy of Civil Aviation Science and Technology, as authorised by the Department of Policy, Law and Regulation of CAAC, and can register the relevant party's rights to civil aircraft. To date, there is no separate rights register for aircraft engines.

The CAAC also published a rule on 16 May 2017 that requires the owner of an unmanned aircraft system (UAS), sometimes called a drone, to register drones of a take-off weight of 250 grams or over with the CAAC's UAS registration system.

China has designated the CAAC as an authorising entry point for registration on the International Registry. According to the CAAC's regulations, the parties have to obtain Authorising Entry Point (AEP) codes from the CAAC to perform registrations on the International Registry against aircraft with Chinese nationality. The China Academy of Civil Aviation Science and Technology, as authorised by the Department of Policy, Law and Regulation of the CAAC, is now responsible for granting the AEP codes.

Shipping

The branch offices of the MSA are the authorities that administer the nationality and rights registrations of vessels that fly the Chinese flag according to the Maritime Law of China, the Regulations on Vessel Registration of China and the administrative rules issued by the MSA. The vessels that can fly the Chinese flag include: (1) vessels that are owned by Chinese citizens whose domicile or main place of business is in China; (2) vessels that are owned by an enterprise legal person established according to the laws of China and having its principal place of business in China (if such legal person is a foreign-invested company, the equity

owned by the Chinese investor is no less than 50 per cent unless otherwise permitted by the MSA); (3) the public vessels of the Chinese government or the vessels owned by Chinese institutional legal persons; and (4) the vessels on a bareboat charter to Chinese entities.

ii Specific practices

Compliance with China's foreign exchange regulations is essential for foreign financiers' financing to a Chinese debtor in transport finance, particularly in respect of the rules on foreign debt control and provision of cross-border security for the financing. The State Administration of Foreign Exchange (SAFE) is the authority responsible for enforcement of China's foreign exchange regulations. The completion of the applicable foreign debt and cross-border security approval, filing and registrations requirements are normally conditions precedent for the disbursement of the financing.

Foreign debt regulation

For regulation purpose, foreign debt refers to the financial indebtedness (which may be in the form of a loan, a cross-border financial lease or an issuance of bonds) owed by a Chinese debtor to a foreign creditor. To borrow a foreign debt, the Chinese debtor needs to ensure that it has a sufficient foreign debt quota (such quota is determined according to a formula by reference to the Chinese debtor's net assets, the applicable cross-border finance leverage ratio and China's macro-economy adjustment factor; subject to approval by SAFE, the special purpose companies established in Tianjin Dongjiang Free Trade Port Zone for leasing projects may share the foreign debt quota of their parent leasing companies), and complete the filing with the NDRC or its authorised local counterpart (since 14 September 2015, the financial indebtedness of the offshore entity controlled by a Chinese enterprise is also required to be filed with the NDRC). In addition, after the execution of the relevant foreign debt agreement, the Chinese debtor needs to register such agreement with the SAFE and such registration is a pre-condition of the Chinese debtor to open a bank account to receive the funds of the foreign debt and to remit funds out of China to repay the foreign debt.

Cross-border security regulation

According to the regulations of the SAFE, a security arrangement may constitute a cross-border security if: (1) the provider of the security makes a legally binding undertaking to the creditor that it will perform the relevant payment obligation according to the security agreement; and (2) such arrangement may cause cross-border payment and receipt of funds or cross-border transfer of asset ownership.

The security arrangement may take the form of a guarantee, pledge, mortgage and other forms of security that are permitted by applicable law.

For a cross-border security arrangement, if the provider of the security is established and registered in China, and the debtor and the creditor are established and registered in offshore jurisdictions, the provider of the security is required to register such cross-border security with the SAFE. There are also certain conditions for using this cross-border security structure in certain particular types of finance, including: (1) if the secured debt is the issued bonds, the Chinese security provider shall have, directly or indirectly, equity interest in the debtor; (2) if the funds of the secured debt are used to acquire equity interest in or to be borrowed to an offshore entity, the acquisition of such equity interest and the lending shall comply with the outbound investment regulations of the Chinese authorities; (3) if the secured debt is the payment obligation under a derivative transaction of the debtor, the

purpose of this derivative transaction shall be for hedging only, and such transaction shall be within the debtor's business scope and duly authorised by its shareholders; (4) the funds of the secured debt shall only be used for relevant expenses within the normal business scope of the debtor concerned, and cannot be used to support the debtor in engaging in transactions beyond the normal scope of its business, for arbitrage under fabricated trade background or for other forms of speculative transactions; and (5) the funds of the secured debt shall not directly or indirectly be repatriated by way of making securities investments, but can be directly or indirectly transferred for domestic use by domestic lending, equity investment or otherwise. The eligibility of the debtor, the use of funds of secured debt, the relevant transaction background, the expected source of funds for repayment and the possibility of the performance of the security are examined by the SAFE or a bank.

If the provider of the cross-border security is established and registered in an offshore jurisdiction, and the debtor and creditor are established and registered in China, the following conditions need to be satisfied: (1) the Chinese debtor has to be a non-financial institution registered in China; (2) the Chinese creditor has to be a financial institution registered in China; (3) the secured debt has to be a yuan commitment or foreign exchange lending (other than entrusted loans) or legally binding lending commitment; and (4) the form of the security must comply with Chinese law and the applicable foreign law. According to the rules of the SAFE, the Chinese creditor needs to report the relevant data of its finance secured by such security structure to the SAFE, and after enforcement of the security, the Chinese debtor needs to register its obligation to indemnify the offshore security provider as a foreign debt.

In respect of the rental payments, even though in general no foreign currency shall be circulated within the territory of China and no foreign currency shall be used for pricing or settlement purposes, according to the Notice of Foreign Exchange Administrative on Finance Leasing promulgated by the SAFE on 13 October 2017, the financial leasing companies regulated by the China Banking and Insurance Regulatory Commission (CBIRC) (from 20 April 2018, all foreign-invested financial leasing companies and domestic financial leasing companies that were regulated by MOFCOM previously will be regulated by CBIRC thereafter) are capable of receiving foreign currency rental payments if more than 50 per cent of the funds used to purchase the leased asset are from a domestic foreign currency facility or foreign currency foreign debt.

As for the operating lease, there are no national policies with respect to receiving foreign currency rental payments, and according to a special policy granted by SAFE in favour of Tianjin, the lease companies conducting operating lease business in Tianjin Dongjiang Free Trade Port Zone were permitted to receive the foreign currency rental payments in the case of operating leases with Chinese domestic lessees if more than 50 per cent of the funds used to purchase the leased asset are from a domestic foreign currency facility or foreign currency foreign debt, or the leased asset is leased from an offshore lessor and the rental payments need to be paid in foreign currency. This policy has been extended to the lease companies conducting operating lease business through Zhengzhou Xingzheng Comprehensive Bonded Zone in late 2017.

III FINANCIAL REGULATION

China's financial industries are highly regulated.

The PBOC is the central bank of China, which formulates and implements China's monetary policies. The PBOC is also responsible for maintaining and supervising China's

payment, clearing and settlement systems, regulating China's interbank markets and managing China's foreign exchange and gold reserves. The PBOC oversees SAFE, which is the regulator of China's foreign exchange and normally the head of SAFE is also a vice president of the PBOC.

In March 2018, China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC) were consolidated into CBIRC. CBIRC is now responsible for regulation of China's banking industry and insurance market, it supervises banks, financial leasing companies, asset management companies, trust and investment companies, commercial factoring companies, pawn shops, other deposit-taking financial institutions and insurance institutions.

The China Securities Regulatory Commission is the regulator of the securities, capital and futures industries of China.

i Regulatory capital and liquidity

China never implemented Basel I and moved directly onto Basel II and Basel III. Since 2012, China has issued a number of regulatory guidelines and rules to set forth the roadmap and details to implement Basel III in China, including:

- a* the core elements of Basel III standard in the Regulations on Management of Commercial Bank's Capital promulgated in June 2012 (the Capital Regulations);
- b* the supplementary documents for implementation of the Capital Regulations promulgated in October and November 2012;³ and
- c* the implementation policies and documents as to regulation of commercial banks' capital promulgated on 19 July 2013.⁴

The Capital Regulations and their supplementary documents and implementation policies and documents comply with the implementation schedule set forth by the Basel Committee on Banking Supervision for Basel III, and apply to all commercial banks incorporated in China, and certain non-bank financial institutions (including group financial companies, consumer finance companies, financial leasing companies, automobile finance companies, lending companies and rural credit cooperatives). The Capital Regulations do not apply to policy banks that do not accept deposits from the public.

In a few areas, China has adopted a stricter approach than the minimum standards prescribed by Basel, including those outlined below.⁵

The Capital Regulations not only apply to China's international banks, but also apply to all other commercial banks, including those small banks and local banks.

3 The full names of these documents are the Supervisory Guidance on Capital Instruments Innovation for Commercial Banks and the Notice of the CBRC on Transition Arrangements for the Implementation of the Capital Rules for Commercial Banks.

4 These policies and documents include the Notice on Measurement Rules of Capital Requirements for Bank Exposures to Central Counterparties (CCPs); the Notice on Enhancing Disclosure Requirements for Composition of Capital; the Notice on Regulatory Policies for Implementing IRB of Commercial Banks; and the Notice on Policy Clarification of Capital Rules. These policies and documents provide for further clarifications and rules on exposures to central counterparties (CCPs), disclosure requirements for capital instruments, requirements for internal ratings-based approach (IRB) implementation and certain technical clarifications.

5 The Assessment of Basel III regulations-China published by Basel Committee on Banking Supervision on 27 September 2013. The full report is available at <http://www.bis.org/press/p130927.htm>.

There is no phase-in arrangement for the minimum capital ratio. Commercial banks should meet a minimum ratio of 5 per cent CET1, 6 per cent Tier 1 and 8 per cent total capital as of 1 January 2013. The minimum requirement for CET1 is 5 per cent rather than 4.5 per cent as required by Basel. The requirement for CET1 including the capital conservation buffer is 7.5 per cent instead of 7 per cent as required by Basel.

The Capital Regulations generally apply a risk weight of 1,250 per cent to commercial banks' equity investments in commercial entities, with the only exception of a 400 per cent risk weight applied to 'equity investments in commercial entities passively held by the bank within the legally prescribed disposal period' and 'equity investments in commercial entities made by the bank due to policy reasons and with the special approval of the State Council'.

Under the Standardised Approach for credit risk, claims secured by residential property are risk weighted at 50 per cent rather than 35 per cent, the minimum required by Basel.

In May of 2018, China issued the revised rules on management of liquidity risks for commercial banks. The revised rules added three quantitative ratios to monitor the banks' liquidity risk, which are: (1) the Net Stable Funding Ratio, which measures banks' long-term stable funding to support business development; (2) the High-quality Liquidity Asset Adequacy Ratio, which is the bank's high-quality liquidity assets divided by short-term net cash outflow, and the minimum ratio required is 100 percent; and (3) the Liquidity Coverage Ratio, and the minimum ratio required is 100 percent.

ii Supervisory regime

Lending is a regulated business in China and Chinese law generally prohibits an unlicensed Chinese company from lending money to another Chinese company (the cross-border loans are not subject to such prohibition). Therefore, the lendings between Chinese companies are usually done through a licensed Chinese bank through an 'entrusted loan'. Under an entrusted loan, the lender, the borrower and the entrusted Chinese bank will enter into an entrusted loan agreement and the lender will disburse the loan to the borrower through the entrusted bank. The lender, not the entrusted bank, shall bear all borrower's credit risks by itself. After the promulgation of the 'Administrative Measures for Entrusted Loans of Commercial Banks' on 5 January 2018, the lender could basically only use its own proprietary funds to disburse the 'entrusted loan', and the use of the 'entrusted loan' is also strictly constrained.

China also has mandatory requirements on the portion of the loan provided by a Chinese bank in the whole investment amount of the financed project (the maximum lending ratio). Such maximum lending ratios vary according to the industry of the financed project. As to transport related industries, the maximum lending ratios are 20 per cent for railway, road and urban railway transport project, and 25 per cent for airport, harbour and coastal and inland waterway projects. The State Council is empowered to change such ratios from time to time according to the circumstances of China's economy.

The Chinese financial institution's ability to provide finance to a debtor may also be limited by the applicable regulatory requirements. For example, for a financial leasing company, its ability to provide financial leasing finance to a lessee may be limited by:

- a* the single customer finance concentration ratio (i.e., the unpaid balance of all financial leases to a single company may not exceed 30 per cent of its net capital);
- b* the single group customer finance concentration ratio (i.e., the unpaid balance of all financial leases to all companies within the same group may not exceed 50 per cent of its net capital);

- c* the single related-party finance ratio (i.e., the unpaid balance of all financial leases to a single related party of the financial leasing company may not exceed 30 per cent of its net capital);
- d* the all related-party finance ratio (i.e., the unpaid balance of all financial leases to all related parties of the financial leasing company may not exceed 50 per cent of its net capital); and
- e* the single shareholder finance ratio (i.e., the unpaid balance of all financial leases to a single shareholder of the financial leasing and all related parties of such shareholder may not exceed all capital contributed by such shareholder).

The lendings and financial leases from offshore companies to Chinese debtors are subject to the foreign debt regulations discussed above, and the relevant Chinese debtor shall have sufficient foreign debt quota and complete the relevant foreign debt filing and registration procedures.

IV SECURITY AND ENFORCEMENT

i China's rights registration regime in asset finance

Aircraft

The following rights and security interest can be registered with the CAAC Rights Register:

- a* owner's title to the aircraft;
- b* mortgagee's mortgage right to the aircraft;
- c* priority right to the aircraft; and
- d* lessee's possessory right to the aircraft under a lease duration that is no less than six months.

According to the Civil Aviation Law, it is not a mandatory requirement to register the title of, mortgage or possessory right in a civil aircraft with the CAAC Rights Register, but without such registration, the title, mortgage or possessory rights have no legal effect against other *bona fide* third parties; and without registration with the CAAC Rights Register, the relevant party's priority right shall terminate on the date falling three months after the occurrence of the event out of which such priority right arose.

The priority rights to a civil aircraft shall have priority over the security interest in the civil aircraft in relation to compensation concerning such civil aircraft.

After the Cape Town Convention took effect in China, the CAAC Rights Register and the International Registry function in parallel. Filing with the International Registry is a must if the creditor wishes to retain its priority under the Cape Town Convention and the registration with CAAC is necessary to preserve its priority under Chinese domestic security law.

Shipping

The following rights and security interest can be registered in the register book maintained by the MSA:

- a* the owner's title to a completed vessel or a vessel under construction, and, if applied by the owner, the vessel's funnel mark or house flag;
- b* the mortgagee's mortgage right to the vessel; and
- c* the bareboat charter.

According to the Regulations on Vessel Registration of China and the rules issued by the MSA, it is not a mandatory requirement to register the title of or the mortgage right in a vessel with the MSA but without such registration, the title or mortgage rights have no force against other *bona fide* third parties. It is a mandatory requirement to register the bareboat charter if the bareboat charter is related to: (1) a domestic charterer chartering a Chinese-flagged vessel; (2) a domestic charterer chartering a foreign-flagged vessel; or (3) a foreign charterer chartering a Chinese-flagged vessel. During the period of the charter, the charterer cannot register the re-letting of the vessel without the prior consent of the vessel owner. Additionally, the mortgage rights over a vessel under a registered bareboat charter can only be registered if the registered charterer's consent has been obtained.

As to the international conventions on the property rights and the security interests, China has signed the International Convention on Maritime Liens and Mortgages on 18 August 1994. However, this Convention has not been ratified yet and is not effective in China.

Rail

China does not maintain a register of title or other rights in respect of rolling stock. The mortgage over rail stock is treated as a mortgage over movables.

The mortgage over movables can be registered with the local office of the State Administration of Industry and Commerce (which maintains the company registry in China) where the mortgagor is registered.

ii Financing of contracts

Aircraft

In China's market, the financiers of Chinese airlines include ECAs, Chinese banks (including both commercial banks and policy banks), foreign commercial banks, Chinese lessors and foreign lessors. The financing may take the form of direct lending, financial leases, operating leases, ECA financings and other structured financings. Recently, the lease-in, lease-out structure is also very popular in the market, in which the offshore lessor head leases the aircraft to a special purpose company set up in a Chinese tax bonded area and then this special purpose vehicle subleases the aircraft to the Chinese airline. The risk profile and the detailed legal documentation for this structure differs depending on whether the special purpose company in the tax bonded area is set up by the offshore lessor or the Chinese airline.

The typical security package to the financier of the aircraft may consist of:

- a* mortgage over the aircraft;
- b* assignment of insurances;
- c* airframe and engine warranties assignments;
- d* assignment of lease agreement;
- e* pledge over receivables in respect of the aircraft;
- f* guarantee from the parent company;
- g* escrow and pledge over the relevant bank accounts; and
- h* pledge over the equity of the special purpose project company.

Shipping

Chinese law permits a mortgage over a ship under construction. A Chinese shipbuilder may mortgage its ship under construction to a financial institution in China to obtain finance, and such mortgage can be registered with MSA's ship registry. The shipowners are not allowed to mortgage the ship under construction yet.

Normally, the account bank of the Chinese shipbuilder can issue a pre-delivery payments refund guarantee in favour of the shipowner, and the shipowner can assign such guarantee together with its interests and rights under the shipbuilding contract to its financier as security of the pre-delivery payments finance.

The typical security to the financier of the ship may consist of: (1) mortgage over the ship; (2) the general pledge and assignment of insurances, ship charters etc.; and (3) pledge over receivables in respect of the ship.

Rail

Typically, the CRC will contract with the rolling stock manufacturers for purchase and finance the purchase of rolling stock through its financiers.

iii Enforcement

Chinese law does not expressly accept 'self-help' remedies or equivalent concepts. However, if the debtor or mortgagor does not cooperate, the creditor may have to enforce its rights through legal actions of the court.

The mortgage agreement can provide for the circumstances in which the mortgage may be enforced and contractual rights that the mortgagee may have upon enforcement. The typical trigger events that would result in enforcement of the mortgage include the failure to pay any amount due under the financing or the occurrence and continuance of other event of default.

In addition to the mortgagee's contractual enforcement rights under the mortgage agreement, the Security Law of China and the Property Law of China also provide for certain statutory rights for the mortgagee to enforce the mortgage, which include the auction of the mortgaged property, the transfer of the ownership of the mortgaged property to the mortgagee with consent of the mortgagor after the enforcement to satisfy the debt, and the private sale of the mortgaged property with consent of the mortgagor. Under Chinese law, it is not lawful to set forth in the mortgage agreement that the mortgagee can foreclose the mortgaged directly upon enforcement.

iv Arrest and judicial sale

Arrest

Under Chinese law, a creditor may petition to the competent Chinese court to arrest the aircraft, ship or the rolling stock upon enforcement:

- a* either before the litigation, if the creditor can show to the court that the circumstances are urgent and the creditor's lawful rights and interests will suffer un-remediable harms without immediate preservation of the aircraft, ship or rolling stock; or
- b* during the litigation process, if the creditor can show to the court that without arrest of the aircraft, ship or rolling stock, it will be impossible or difficult to enforce the subsequent court judgment or order or will cause other damages to the creditor because of the actions of the mortgagor or other reasons.

If the petition is raised before the litigation, the creditor shall provide security, or the court will reject the petition.

If the action is brought up against the mortgagor in a foreign court rather than a Chinese court, it would be very difficult for the Chinese court to order asset preservation against the mortgaged property in China.

The arrest of the ships is not dealt with by the ordinary people's court in China, but is subject to the jurisdiction of a maritime court of China (which is a special type of court formed to hear maritime litigations).

Judicial sale

If the debtor is not cooperative upon enforcement, the creditor may sue the debtor and petition to the court to enforce its rights. Set out below is a general description of the typical civil litigation procedures in China.

A bill of complaint is submitted to the appropriate court, setting forth the name and address of the defendant, the claim and the facts and legal bases of the case and the evidence that will support it. The Chinese court in the location of the domicile of the defendant, the place where the contract is performed, or the place chosen by the parties through written agreement and having actual connections with the dispute would have jurisdiction.

If the Chinese court finds the bill of complaint acceptable (within seven days), it will file the case and will send a copy of the bill of complaint to the defendant (within five days from such filing). For the party that files the lawsuit, a court fee will be payable as well as the usual litigation costs.

The defendant should file a bill of defence with the court (within 15 days). However, failure by the defendant to file a bill of defence shall not affect the hearing of the case by the court.

After the court determines the date of trial, a trial will be held and a judgment rendered (within an extendable six-month period), although appeals to higher courts are permitted.

With the enforcement of General Provisions of the Civil Law since 1 October 2017, the general period of limitation of actions on a request to the Chinese court for the protection of civil rights is three years, such period being calculated from the time it was known, or should have been known, that a right was infringed upon. If more than 20 years have passed since the date of the infringement of the right, the Chinese court shall offer no protection.

In addition to the above, parties to a dispute may reach a settlement agreement at any time before judgment (therefore, a court-approved mediation settlement is permitted to be entered into between a foreign lessor and a Chinese airline). If a settlement agreement is reached, the court will draw up a mediation decision. If a judgment or mediation decision requires enforcement, additional court fees as well as actual expenses for enforcement must be paid by the party seeking enforcement.

To facilitate enforcement of security interest and improve protection of the creditor, the Civil Procedure Law of China (Civil Procedure Law) also provides for a fast-track procedure for enforcement of security interest. According to the Section 7 of Chapter 15 of the Civil Procedure Law, provided that there is no substantive dispute, the holder of the security interest may petition to the court for auction or sale of the property subject to the security interest. In this fast-track procedure, the court would review and determine whether the conditions for enforcement of the security have been satisfied and if they have, the court will make an enforcement order within 30 days.

As to those security documents that are submitted to the jurisdiction of foreign court, in the event that a final and conclusive judgment is obtained from the foreign court, such judgment can be recognised and enforced in China without re-examination or re-litigation on the subject matter thereof, if the following conditions are met:

- a* the judgment is made by a foreign court with competent jurisdiction and is final and conclusive;
- b* the jurisdiction of the foreign court is not precluded by any law, order or treaty;
- c* service of process for any proceeding against the Chinese party in the jurisdiction of the competent court has been lawfully effected on the Chinese party (other than by public notice), or the Chinese party has appeared and responded on the merits of the case in the relevant proceedings without receiving service thereof;
- d* the court of China is satisfied that the judgment neither contradicts the basic principles of the laws of China nor violates China's state sovereignty, security and public interest; and
- e* judgments of Chinese courts receive reciprocal treatment in the jurisdiction of the foreign court; as a matter of Chinese law, this means that there exists a bilateral or multilateral treaty concluded or acceded to by China and the jurisdiction of the foreign court as to the mutual recognition and enforcement of judgments. To date, there has been no bilateral or multilateral treaty between China and the United Kingdom or United States in connection with the recognition or enforcement of court judgments; therefore, the judgments made by US or UK courts cannot be enforced in China directly.

V CURRENT DEVELOPMENTS

i Recent cases

Aircraft

The precedent case in repossession and enforcement against civil aircraft is rare in China's record. The bankruptcy of Dongxing Airline after the financial crisis in 2008 and the repossession of the aircraft leased to Dongxing by GECAS has been an important case that tested Chinese laws for a foreign operating lessor to repossess its aircraft.

Shipping

A recent case is the arrest of a ship named *MVAmin2*. Because of a dispute in respect of a loan to ISIM Amin Limited, and a mortgage over the *MVAmin2* provided thereto and in which ISIM Amin Limited transferred the *MVAmin2* to Shokooh Sahar Kish Shipping without the permission of the lender, the lender, which is DVB Bank SE, filed an application with Xia Men Maritime Court for arresting the *MVAmin2* before litigation. Xia Men Maritime Court ruled to permit such pre-litigation property preservation claim. During the litigation, the Xia Men Maritime Court putted the *MVAmin2* into judicial sale upon application of DVB Bank SE for ISIM Amin Limited's failure to provide guarantee. After the judicial sale, parties reached a mediation agreement and the relevant judicial procedures carried out in other countries were ceased or withdrawn. In this case, all the parties are foreign legal entities and the case facts took place abroad; however, the plaintiff voluntarily selected a Chinese court to resolve the dispute, which fully reflects the international credibility of China's maritime justice.

ii Developments in policy and legislation

To boost its economy, China aims to cut its overall tax burden of the enterprises and has continued to reform its turnover tax system. One development worth noting is the further reform of China's value-added tax policies, particularly on deduction of the value-added tax on the interest paid by a Chinese debtor to the financial institutions from its overall value-added tax payable, and the share of value-added tax revenue between the central government and the local government that may affect the fiscal incentives provided by the local government to attract financiers in the transport finance industry.

The Ministry of Finance of China and the State Taxation Administration issued the Notice on Adjusting Value-added Tax Rates on 4 April 2018, which deducted the value-added tax rates applicable to a few industries, including the leasing industry. It is expected that the value-added tax rate applicable to the leasing industry may be further reduced in 2019. China also abolished import value-added tax on aircraft 'imports by way of leasing' with effect from 1 June 2018. This helped to address the double taxation problem for cross border aircraft leasing and is expected to further boost the aircraft leasing industry.

On 7 December 2018, the Ministry of Finance of China issued the revised Accounting Standards for Business Enterprises No. 21 – Leases (2018), which, broadly speaking, adopted the same approach under the International Financial Reports Standards (IFRS) 16 set by the International Accounting Standards Board (IASB). According to the revised accounting standards, all leases are expected to be reflected on the financial statements of Chinese airlines. The adoption of these revised accounting standards will potentially affect a number of financial tests and ratios customarily used in aircraft leasing and lending documentation in the Chinese market.

INDIA

*Shardul J Thacker*¹

I INTRODUCTION

The transportation industry – aviation, shipping and rail – has been predominantly owned by government entities since India's independence in 1947. Historically, Air India and Indian Airlines (now merged into Air India Limited), both government-owned entities, ruled the skies. The Shipping Corporation of India Limited (SCI), established in 1961 and owned by the government, owned and operated around one-third of the Indian tonnage. All railway property has always exclusively been government-owned.

However, this trend has recently been changing. The recent government in India has taken up disinvestment through minority stake sale (i.e. retaining ownership of at least 51 per cent of the shareholding and management control) or even strategic sale of a substantial portion (50 per cent or more) of the government shareholding along with transfer of management control of certain identified central public sector enterprises. On 28 June 2017, the government of India announced the privatisation of Air India Limited. A committee has been set up to start the process. The government is also aggressively considering strategic disinvestment in the Shipping Corporation of India. In any case, with the constant and steady increase in the Indian fleet, and no new acquisitions by SCI, presently SCI only owns around 5 per cent of the total Indian fleet.

i The transport finance industry

Shipping and aviation are global industries, with cyclical ups and downs. Indian entrepreneurs, in the context of other industries, have not considered these sectors as 'safe havens' for their investments. Both are also dollar-based industries, and global banks tend to focus on large fleet-owners of aircraft and ships, which are rare in India. The financing costs of the Indian banks are not competitive in terms of global financing, as interest rates are quite high.

Owing to the vast difference in the costs of domestic borrowing and external commercial borrowing (ECB), Indian companies have for a long time obtained finance for the acquisition of ships and aircrafts from foreign banks and financial institutions such as DNB Bank ASA, ING Bank NV, BNS Asia Limited, Bank of America NA located predominantly in Singapore, Hong Kong and Dubai. Indian banks such as SBI, ICICI and Axis Bank also provide finance through their offshore branches. The regulations governing ECB are framed by the Ministry of Finance and the Reserve Bank of India (RBI), and ECB borrowed by Indian companies

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to finance the cost of acquisition of ships must be in accordance with the Foreign Exchange Management Act, 1999 and the rules, regulations, guidelines, notifications and circulars issued thereunder.

ii Recent changes

Under the ECB policy, as advanced from time to time, shipping companies can obtain loans from foreign banks and financial institutions, and suppliers of equipment, in addition to their foreign equity holders. In addition to loans, Indian entities can also acquire new ships on a supplier's credit (credit advanced by the overseas supplier) or buyer's credit (loan availed by the importer from foreign bank or financial institution) basis.

To improve the ease of doing business in India, the RBI, by its notification dated 16 January 2019, further rationalised the ECB framework and the Master Direction is in the process of being revised to reflect the changes brought in by this notification. The salient features of the new ECB framework are set out below:

- a* ECBs are now categorised under two broad heads, 'foreign currency denominated ECB' and 'rupee denominated ECB'.
- b* The eligibility criteria for an organisation to be able to avail ECB has now been expanded to include all entities eligible to receive foreign direct investment (FDI). Additionally, port trusts, units in special economic zones, Small Industries Development Bank of India, EXIM bank, registered entities engaged in micro-finance activities, registered not-for-profit companies, registered societies, trusts, cooperatives and non-government organisations can also borrow under this framework. Thus, a society or a trust registered in India and owning a ship can now avail ECB from a foreign lender.
- c* Similarly, the category of persons that can lend has also been widened. Multilateral and regional financial institutions, individuals and foreign branches or subsidiaries of Indian banks can also be lenders. The criteria for qualifying as a lender is that a person should be resident of a Financial Action Task Force or International Organization of Securities Commission compliant country.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Shipping

Flag or mortgage registration

The registration of Indian ships and mortgages is governed by:

- a* the Merchant Shipping Act, 1958 (MSA);
- b* the Merchant Shipping (Registration of Indian Ships) Rules, 1960, as amended from time to time; and
- c* notifications issued by the Ministry of Shipping and the Directorate General of Shipping (DGS) under the MSA from time to time.

The Merchant Shipping Bill, 2016 was introduced in the Lok Sabha on 16 December 2016 for replacing the MSA. Some of the proposed changes (to the existing law) under the Bill are as follows:

- a* For a vessel to be an Indian vessel or an Indian controlled tonnage, it should be substantially (i.e. more than 50 per cent of the shares of the vessel) owned by an Indian citizen or a body established under any Central Act or State Act of India.
- b* An Indian vessel can also be registered in a country other than India, subject to certain conditions, as may be prescribed.
- c* It seeks to repeal the Coasting Vessels Act, 1838 (under which non-mechanically propelled vessels are presently registered). Consequently, the new Merchant Shipping Act (if enacted) will deal with registration of all seagoing vessels, including rigs. It further permits creation of mortgages over the rigs, for which such mortgage over rigs would be subject to the same rights and obligations as any self-propelled ship or vessel.
- d* It will allow registration of the vessel chartered on a bareboat cum demise (BBCD) basis by an Indian charterer with the Indian registry. Such registration of vessels chartered on a BBCD basis will remain in force until the end of the charter period, provided any provisions of the Act (i.e. Merchant Shipping Bill once enacted) are not violated. The vessel chartered on BBCD, once registered under Chapter II of the new Merchant Shipping Act (i.e. Merchant Shipping Bill once enacted), shall become an Indian vessel and will be entitled to fly the Indian flag. However, such registration would not be mandatory.

Since July 2014, Indian shipping companies can own foreign-flagged ships subject to compliance with the DGS guidelines. The Indian-controlled tonnage scheme allows ship-owners based in India to acquire ships abroad and flag them in the country of their convenience – typically tax-friendly jurisdictions to help access competitive sources of funds – while achieving fiscal and cargo benefits available in India.

Under India's stringent cabotage policy, no foreign ship could engage in coastal trade between two Indian ports except under a licence issued by the DGS. However, the cabotage policy has recently been relaxed on multiple occasions. In 2012, the cabotage policy was relaxed at the International Container Trans-shipment Terminal (ICTT) Vallarpadnam, Cochin for EXIM container cargos. This relaxation enabled foreign vessels to call at the ICTT. The ICTT is only 76 nautical miles from the main east–west shipping route, allowing the discharge of Indian cargo at Cochin rather than at neighbouring mainline trans-shipment ports such as Colombo or Singapore. In 2015, cabotage was relaxed for certain special vessels for five years, up to 2020. The cabotage policy was also relaxed to allow foreign-flagged vessels carrying passengers to call at more than one Indian port for a period of 10 years (i.e., from 6 February 2009 to 5 February 2019) without obtaining a licence from DGS. This relaxation period was further extended for a period of five years (i.e., up to 5 February 2024). In 2018, the cabotage policy has been further relaxed in relation to the foreign-flagged ships engaged in the following coastal activities:

- a* transportation of EXIM laden containers for transshipment and transportation of empty containers;
- b* carriage by sea of prescribed agricultural, fisheries, animal husbandry and horticultural commodities; and
- c* carriage by sea of fertilisers.

Such relaxation of the cabotage rules will attract more containerised cargo and result in the growth of the shipping industry, allowing India to compete internationally with other countries in terms of international shipments. Foreign shipping companies shall be able to take cargo directly from one port to another, which will allow them to accommodate more containers. EXIM containers transported by foreign-flagged vessels for trans-shipment at Indian ports in August 2018 exceeded the empty containers moved on by foreign vessels, providing sufficient indication that the policy shift has begun to benefit the industry. Relaxation has encouraged farmers to access a larger market, widen the range of goods and products and provide a greater distance for conducting domestic trade. Cabotage relaxation shall also help in acquiring a 5–7 per cent cost saving for the cotton and textile industry, as it will help export goods from domestic ports itself.

Admiralty proceedings

The recently enacted Admiralty (Jurisdiction and Settlement of Maritime Claims) Act, 2017 (Admiralty Act), which came into force on 1 April 2018, consolidates the existing laws relating to admiralty jurisdiction of courts, admiralty proceedings on maritime claims, arrest of vessels and stipulates the order of priorities for maritime claims/liens *inter se* as well as other claims and related issues. It also repeals five obsolete British statutes on admiralty jurisdiction in civil matters, namely:

- a the Admiralty Court Act, 1840;
- b the Admiralty Court Act, 1861;
- c the Colonial Courts of Admiralty Act, 1890;
- d the Colonial Courts of Admiralty (India) Act, 1891; and
- e the provisions of the Letters Patent, 1865, applicable to the admiralty jurisdiction of the Bombay, Calcutta and Madras High Courts.

The Admiralty Act seeks to fulfil a long-standing demand of the legal fraternity. The Admiralty Act has a retrospective application and therefore all admiralty proceedings pending before commencement of the statute in the concerned High Courts, as well as all actions initiated, and even the by-laws, rules framed and notices issued under the repealed enactments will now be adjudicated by the provisions of the Admiralty Act, so long as they are not inconsistent with the provisions of the same.

The Admiralty Act confers admiralty jurisdiction on High Courts of coastal states. This jurisdiction extends up to Indian territorial waters. The central government is empowered to further extend, by notification, up to the exclusive economic zone or any other maritime zone of India or islands constituting part of the territory of India. The Admiralty Act covers every vessel irrespective of the place of residence or domicile of owner.

India has adhered to the 1952 Arrest Convention and 1999 Arrest Convention and accordingly under the Admiralty Act, arrest can be sought for all claims that have been included in the definition of the term 'maritime claims' under the 1999 Arrest Convention. Additionally, under the Admiralty Act, the following maritime liens are also treated as maritime claims for which an arrest can be sought:

- a claims for wages and other sums due to the master, officers and other members of the vessel's complement in respect of their employment on the vessel, including costs of repatriation and social insurance contributions payable on their behalf;
- b claims in respect of loss of life or personal injury occurring, whether on land or on water, in direct connection with the operation of the vessel;

- c* claims for reward for salvage services, including special compensation relating thereto;
- d* claims for port, canal and other waterway dues and pilotage dues and any other statutory dues related to the vessel; and
- e* claims based on tort arising out of loss or damage caused by the operation of the vessel other than loss or damage to cargo and containers carried on the vessel.

While determining maritime claims under the specified conditions, the courts may settle any outstanding accounts between parties with regard to the vessel. They may also direct that the vessel or a share of it be sold. With regard to a sale, courts may determine the title to the proceeds of such sale. Maritime liens are given the highest priority among all claims, followed by mortgages and all other claims. In the case of maritime claims, claim for wages is given the highest priority, followed by claims with regard to loss of life or personal injury, reward for services, port, canal and other statutory dues, and lastly by claims based on tort arising out of loss or damage caused by the operation of the vessel. Such claims shall continue to exist even with the change in ownership or registration or flag of the vessel.

Courts may exercise admiralty jurisdiction against a person with regard to maritime claims. However, the courts will not entertain complaints against a person in respect of a damage or loss of life or personal injury arising out of any of the following: (1) collision between vessels; (2) the carrying out of or omission to carry out, a manoeuvre in the case of one or more vessels; or (3) non-compliance on the part of one or more vessels, with the collision regulations made in pursuance of the MSA, unless (1) the cause of action, wholly or in part, arises in India; or (2) the defendant, at the time of commencement of the action by the High Court, actually and voluntarily resided or carried on business or personally worked for gain in India.

Further, courts will not entertain action against a person until any case against them with regard to the same incident in any court outside India has ended.

The courts may order the arrest of any vessel within their jurisdiction for providing security against a maritime claim that is the subject of a proceeding. They may do so under various reasons, such as:

- a* the owner of the vessel is liable for the claim;
- b* the demise charterer of the vessel is liable for the claim;
- c* the claim is based on the mortgage or charge of similar nature on the vessel;
- d* the claim relates to ownership or possession of the vessel; or
- e* the claim is against the owner, demise charterer, manager or operator of the vessel and is secured by a maritime lien.

With regard to appeals, any judgments made by a single judge of the High Court can be appealed against a division bench of the High Court. Further, the Supreme Court may, on application by any party, transfer an admiralty proceeding at any stage from one High Court to any other High Court. The latter High Court will proceed with the matter from the stage where it stood at the time of the transfer.

In addition, the Major Ports Authorities Bill, 2016 (the Bill) was introduced in the Lok Sabha on 16 December 2016. The Bill seeks to repeal the Major Port Trusts Act, 1963 and seeks to provide greater autonomy and flexibility to major ports. It provides for the creation of a board of major port authority for each major port. The Bill decentralises decision making and ensures transparency in operations. The Bill provides for the composition of the board and ensures that various stakeholders including railways, customs, revenue, local state

governments and road authorities are adequately represented. The Bill defines public-private partnership projects as projects taken up through a concession contract by the board on a revenue or royalty-sharing basis. The appointed concessionaire will be free to fix the actual tariffs based on market conditions. It also envisages creation of an adjudicatory board for adjudication of disputes and looking into complaints received from port users.

Aviation

The civil aviation sector is regulated by:

- a* the Aircraft Act, 1934 and the Aircraft Rules, 1937;
- b* the Airports Authority of India Act, 1994;
- c* the Airports Economic Regulatory Authority of India Act, 2008;
- d* the Civil Aviation Requirements, issued from time to time;
- e* the Convention on International Interests in Mobile Equipment, 2001 and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, 2001 (Cape Town Convention);
- f* the Carriage by Air Act, 1972;
- g* the Aircraft (Carriage of Dangerous Goods) Rules, 2003;
- h* the Foreign Aircraft Exemption from Taxes and Duties on Fuel and Lubricants Act, 2002;
- i* the Tokyo Convention Act, 1975; and
- j* the Suppression of Unlawful Acts against Safety of Civil Aviation Act, 1982.

The Cape Town Convention was ratified by India in 2008 to protect the interests of the lenders and lessors involved in the financing of aircrafts. It provides for the repossession of aircraft or collateral in the event of financial default by the lessee of the aircraft or borrower. It is pertinent to note that although the Cape Town Convention has been ratified, the government of India, except for certain amendments to the Aircraft Rules, 1937 implementing relevant provisions of the Cape Town Convention relating to de-registration and export of aircrafts, has not enacted any legislation as of the time of writing for implementing the Convention. On 8 October 2018, India's Ministry of Civil Aviation opened a public consultation on the prospective wholesale adoption of the Cape Town Convention into Indian law and accordingly published a draft Cape Town Convention Bill on the ministry's website for consultation. The draft bill proposes to make India a full adopter of the Cape Town Convention, which standardises transactions involving movable property.

ii Specific practices

Real-time registration of mortgages over vessels cannot be done in India. Even if all documents required for registration of mortgage over a vessel are submitted to the Registry, registration of mortgages takes around 7–10 working days. Thus, lenders do not have registered mortgage (security) in their favour for this interim period. Having said that, once the mortgage documentation is submitted to the Registry, the mortgage will eventually be registered in favour of the mortgagee after the Registry has verified the documentation. Also, the mortgage shall be recorded in the order of time in which it was submitted for registration to the Registry.

Additionally, while the MSA permits enforcement of a mortgage by a sole mortgagee without intervention of the court, to gain a clean title to the vessel, free and clear of all claims,

liens and encumbrances and to avoid mortgagee's exposure to claims from other parties as also to ensure cooperation of the master and crew, lenders are usually left with no choice but to enforce the mortgage through the admiralty courts.

Also, pursuant to the General Insurance Business Act, 1972, Indian entities are not allowed to insure any of their property in India, including any ship or aircraft registered in India, with insurers whose principal places of business are outside India, except with prior permission of the government. This restriction is not applicable in respect of types of insurance that are not offered by Indian insurance companies – for example, protection and indemnity insurance cover.

The Indian flag, although considered expensive, is still bankable with several international lenders, having lent funds to Indian shipowners, such as SCI, the Great Eastern Shipping Company Limited, Greatship (India) Limited and Mercator Limited.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

In accordance with the RBI guidelines, implementation of Basel III commenced on 1 April 2013 and was intended to be fully phased-in by January 2019. Of late, industry-wide concerns have been expressed about the potential stresses on the asset quality and consequential impact on the performance or profitability of the banks. This may necessitate some lead time for banks to raise capital within the internationally agreed timeline for full implementation of the Basel III Capital Regulations. Accordingly, the transitional period for full implementation of Basel III Capital Regulations in India has been extended to April 2020, instead of 31 March 2019. The RBI has fixed the minimum Tier 1 capital ratio at 7 per cent of risk-weighted assets (RWA), of which 5.5 per cent must be common equity. One of the key features of Basel III is that all non-common Tier 1 and Tier 2 instruments issued by the banks must allow such instruments to be either written off or converted into common equity by banks that have solvency issues. As per audited data of Public Sector Banks (PSBs) for the quarter ended December 2017, all PSBs met the regulatory norm for Common Equity Tier 1. In India, the RBI has not published the requirements on countercyclical capital buffers (zero to 2.5 per cent of RWAs), which aims to ensure that banking sector capital requirements take account of the macro financial environment in which banks operate.

On 31 March 2015, the RBI made several revisions to the Basel III regulations. Pursuant to the revised guidelines that came into effect on 1 April 2015, all new restructured loans must be classified as bad loans and provided for. Banks should accelerate the loan and take recovery action at the earliest opportunity or sell non-performing assets to asset reconstruction companies. This is broadly similar to the situation in US bankruptcy law. The Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR) are significant components of the Basel III reforms. The LCR guidelines that promote short-term resilience of a bank's liquidity profile have been issued by RBI in 2014, whereas the guidelines pertaining to NSFR have been issued by the RBI in 2018. The objective of NSFR is to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance-sheet activities, which will in turn reduce the probability of erosion of a bank's liquidity position because of disruptions in a bank's regular sources of funding that would increase the risk of its failure and potentially lead to broader systemic stress. The NSFR limits

overreliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance-sheet items, and promotes funding stability. It has been hoped that NSFR guidelines would come into effect from 1 April 2020.

ii Supervisory regime

Under the ECB regulations, whether under the automatic route or under the approval route, Indian borrowers have to apply for and obtain loan registration numbers from the RBI. Monthly reporting of withdrawals, utilisation, repayment and other payments is required, including any revisions or modification in the ECB, such as an increase or reduction in the loan amount or revisions to the schedule of disbursements, repayments or interest payments. Thus, the RBI governs and regulates the borrowing of funds and security, and also monitors ECB until it is repaid, including enforcement of security.

Such stringent regulations have reassured foreign banks that borrowers' crucial activities are being overseen. On the other hand, restrictions on charging default interest, on mandatory repayments following a default event, and restrictions on the tenor make loans inflexible, which has put off some foreign lenders.

IV SECURITY AND ENFORCEMENT

The ECB guidelines permit Indian borrowers to grant security of their choice to foreign lenders. Primarily, ships and aircrafts for the acquisition of which the ECB is borrowed are secured in favour of the lenders. No approval is required from the RBI or authorised dealer for creation of a mortgage or charge over the ships and aircraft, as well as for the assignment of insurance, charter hire income of such ships and aircraft. Security over aircraft may also be created by way of hypothecation, fixed or floating charge, lien, pledge, retention of title, conditional sale and assignment.

Pursuant to the MSA, multiple mortgages can be created over a vessel, but the sole mortgagee of a vessel can enforce its rights over the vessel without the intervention of the court, whereas, in the case of multiple mortgages registered over a vessel, a mortgage can only be enforced by applying to the competent court.

i Financing of contracts

Under Indian law, a mortgage can only be created over a vessel that has been provisionally or permanently registered with the Registrar of Ships and cannot be created over a hull under construction. Hence, financing of newly built ships is secured by the assignment of the shipbuilding contract executed between the shipbuilder and the borrower (i.e., purchaser) and the refund guarantees issued by the banks of the shipbuilders in favour of the lenders until such time as the ship is constructed and delivered to the borrower and registered with the Registrar of Ships.

ii Enforcement

Shipping

A mortgage registered over an Indian vessel may be enforced in India or outside India. In India, a vessel can be arrested and sold through the admiralty courts in India by public

auction, thereby vesting in the purchaser a clean title to the vessel, free and clear of all claims, liens and encumbrances. Port dues, admiralty marshal's costs and maritime liens ranking in priority, however, must be paid.

Under the MSA, the sole mortgagee may also enforce a mortgage by taking possession of the vessel and selling it to a third party without the involvement of the courts. Although in law a sole mortgagee has the right to proceed against and sell a vessel without the intervention of the court, in reality the cooperation of the master and crew is necessary. Also, a private sale does not clear the title of the vessel of all claims and encumbrances, and the buyer of the vessel has to acquire the vessel subject to such claims and encumbrances.

A mortgage registered over an Indian vessel can also be enforced outside India, provided the loan documentation permits such enforcement. If the mortgage is enforced outside India, the foreign lender who has obtained a decree from a court in a foreign country can approach an Indian court for enforcement of the decree under the Civil Procedure Code, 1908.

If a judgment has been obtained in any reciprocating territory, the same will be recognised and enforced by the courts in India without re-examination of the issues, provided the judgment is pronounced by a competent court and is on the merits and based on principles of international law, and not opposed to natural justice, or founded on fraud or a breach of any Indian law.

Aviation

The Cape Town Convention confers remedial rights on a lender when the facility has been charged and registered as per the Convention. The chargee can take possession of the aircraft from the lessee in the event of default. Because India is a signatory to the Cape Town Convention, the Directorate General of Civil Aviation (DGCA) will cancel the registration of the aircraft, thereby permitting the chargee to take possession of it.

In the event of financial default, the lessor may unilaterally terminate the agreement and repossess the aircraft or obtain an order from the district court having jurisdiction over the place at which the aircraft is located, for its repossession. The lessors are also required to get the aircraft deregistered from the DGCA prior to repossessing the aircraft. Unless there is an explicit provision in the Cape Town Convention requiring the chargee to seek leave of the court, India has declared that a chargee will not require leave of the court. This can be construed to imply that, even in the case of a bankruptcy of an Indian lessee, such chargee will not be required to obtain leave of the court to repossess the aircraft.

The DGCA requires the consent of the lessee to deregister the aircraft. It may also receive objections to such cancellation from government departments if they are owed money by the defaulting airlines. Moreover, even after deregistration of the lessor's aircraft by the DGCA, the Airports Authority of India may impose a lien on the aircraft for unpaid dues by way of ground rent, landing charges, etc., and has the right to detain the aircraft. Also, the aircraft are sometimes impounded by the custom authorities for non-payment of custom duties, which can be a problem in the repossession of an aircraft by lessors.

The power to detain aircraft and other assets is derived from Section 142(c)(ii) of the Customs Act, 1962 and Section 87(c) of the Finance Act, 1994 (the Finance Act), which allows attachment of 'any movable or immovable property belonging to or under the control' of a defaulter. In a matter brought by the service tax authorities, relating to the attachment of engines belonging to Natixis, the High Court rejected the lien exercised by the service tax authorities. In another similar matter, the International Lease Finance Corporation challenged the attachment order passed under Section 87(c) of the Finance Act by the

service tax authorities – the engines have now been redelivered. In the *Natixis* decision, the court held that property owned by a third party cannot be attached for the dues payable by Kingfisher Airlines.

In the case of *Aer Lingus Limited v. Airport Authority of India*, the Bombay High Court held that if dues are owed by the airline operator to the Airport Authority of India, the owner of such an aircraft cannot be deprived of deregistering and repossessing its aircraft in circumstances where the lessee has outstanding airport parking fees. However, this case is very different from the *Kingfisher* case.

iii Arrest and judicial sale

On 21 September 2016, the Union Cabinet gave its approval to the proposal of Ministry of Shipping to enact The Admiralty (Jurisdiction and Settlement of Maritime Claims) Bill 2016 and to repeal five archaic admiralty statutes.

In Notification No. 675 issued on 22 February 2018, the Ministry of Shipping announced that The Admiralty (Jurisdiction and Settlement of Maritime Claims) Act, 2017 (the Admiralty Act) would come into force on 1 April 2018. Through the Admiralty Act, the application in India of the following enactments have been repealed:

- a the Admiralty Court Act, 1840;
- b the Admiralty Court Act, 1861;
- c the Colonial Courts of Admiralty Act, 1890;
- d the Colonial Courts of Admiralty (India) Act, 1891; and
- e the provisions of the Letters Patent, 1865 insofar as they apply to the admiralty jurisdiction of the Bombay, Calcutta and Madras High Courts.

Prior to the coming into force of the Admiralty Act, India followed the Admiralty Act, 1840 read with the Admiralty Courts Act 1861. These two acts defined the jurisdiction of the Admiralty Courts to arrest vessels. In light of this, the Bombay High Court enjoyed pan-India jurisdiction by virtue of the decision of the Appeal Court in *Kamla Kant Dubey v. MV Umang*.² As a consequence of this decision, it was possible to approach the Bombay High Court to arrest a vessel lying in Chennai, Kolkata or any other port in India.

Section 3 of the Admiralty Act, however, states that the jurisdiction of all maritime claims under the Act shall vest in the respective High Courts and can be exercised up to and within their respective territorial jurisdiction. Thus, the Bombay High Court has now lost the pan-Indian jurisdiction.

Courts may, under the Admiralty Act, order the arrest of any vessel within their jurisdiction for providing security against a maritime claim that is the subject of a proceeding. The Act sets out a list of maritime claims that is similar to Article 1 of the Arrest Convention, 1999. The Admiralty Court also incorporates the following additional claims as maritime claims in relation to which a vessel can be proceeded against and arrested. The claims are related to:

- a port or harbour dues, canal, dock or light tolls, waterway charges and such like;
- b particular average claims;
- c claims by master or crew or their heirs or dependents for wages, cost of repatriation or social insurance contributions;

2 2002 Supp 2 Bom CR 864.

- d insurance premiums, mutual insurance calls;
- e commission or brokerage agency fees payable by vessel owner or demise charterer;
- f environment damage claims or threat thereof; and
- g wreck removal claims.

For admiralty actions, a ship must be in Indian territorial waters. The prerequisite for an admiralty action for enforcing *in rem* rights is that the claimant must demonstrate that the res – the ship – is in Indian waters; hence, no action can be filed in anticipation of a ship that is yet to arrive. A substantive admiralty suit must be filed, unlike in other jurisdictions where only a writ need be entered. Further arrest of bunkers is not permissible in India. As per Indian law, bunkers are not considered to be maritime property. Therefore, the courts exercising admiralty jurisdiction do not permit the arrest of bunkers.³ The Division Bench of the Bombay High Court in *Mansel Limited v. The bunkers on board the Ship m.v. Giovanna Luliano & Ors*⁴ did not accept the contentions of the arrestor that even in England, an admiralty court in exercise of its admiralty jurisdiction can order arrest of bunkers on board a vessel. The Division Bench upheld the view in the matter of *Peninsula Petroleum Limited v. Bunkers on Board the vessel m.v. Geowave Commander Ltd.* Although the matter has been carried on appeal to the Supreme Court of India, the judgment of the Division Bench of the Bombay High Court, however, has not been stayed.

The suit must be filed in the admiralty division of the High Court by submitting a complaint with full documentation. The High Court will schedule a hearing to consider the merits of the claim for arrest. The arrest warrant is issued by the sheriff's office, and is served on the vessel or the master, ports agent and the customs authorities. A court sale is by public auction conducted by the sheriff, inviting offers through advertisements in leading shipping papers such as Lloyd's List or Tradewinds. If the borrower contests the mortgage claim or other creditors apply to intervene in the proceedings, additional hearings are scheduled and the priorities of claim determined. The order of maritime claims determining the *inter se* priority in an admiralty proceeding is determined under Section 10 of the Admiralty Act.

With regard to appeals, any judgments made by a single judge of the High Court can be appealed against a division bench of the High Court. Further, the Supreme Court may, on application by any party, transfer an admiralty proceeding at any stage from one High Court to any other High Court. The latter High Court will proceed with the matter from the stage where it stood at the time of the transfer.

To protect owners or demise charterers of the arrested vessel from possible vexatious and frivolous claims, the High Court may, as a condition of arrest of the vessel, require the arrestor (the claimant) to provide an unconditional undertaking to pay damages or provide security for an amount to be determined by the Court for any loss or damage that the owner or demise charter may suffer as a result of the arrest, should the arrest subsequently be found to be wrongful or if the claimant demanded excessive security.

3 *Peninsula Petroleum Ltd v. Bunkers on Board the Vessel, M.V. Geowave Commander* 2015(3) Bom CR 693.

4 Appeal No. 319 of 2015 by an Order of 5 May 2017.

V CURRENT DEVELOPMENTS

i Recent cases

Shipping

Very recently, the Bombay High Court in *Siem Offshore Redri AS v. Altus Uber*⁵ decided that Section 5(2) of the Admiralty Act, 2017 provides for arrest of any other vessel in the hands of a bareboat charterer in lieu of the vessel against which a maritime claim has been made. Currently the order has been taken up in appeal; however, as of the date of writing, no stay has been granted.

The Bombay High Court recently also determined the time for filing a suit for wrongful arrest as one year from the date of arrest of the vessel. However, where a plaintiff has provided an undertaking to pay damages for wrongful arrest, the one-year limitation period for enforcing such undertaking by way of a counter claim or a notice of motion in the same suit will begin to run from the date the order of arrest is vacated (*MV Tongli Yantai v. Great Pacific Navigation (Holdings) Corporation Ltd.*)⁶

The Kerala High Court in a recent application for detention of a foreign vessel under Section 443 of the MSA ('Power to detain foreign ship that has occasioned damage') held that 'when a foreign vessel is berthed in a port which is within the jurisdiction of another High Court, it cannot be said that the vessel is within the territorial waters of this High Court'. The Court further opined that if the argument advanced by the petitioner is accepted, the High Courts in India will have concurrent jurisdiction to exercise the power under Subsection 1 of Section 443 of the Act. The scheme of Section 443 does not indicate that exercise of concurrent jurisdiction by different High Courts (*Anthonyarpicha v. MV Mayuree Naree*).⁷

In 2017, the Bombay High Court in the matter of *Pacific Gulf Shipping (Singapore) Pte Ltd v. SRK Chemicals Ltd & Anr* (Notice of Motion (L) No. 74 of 2017), held that an admiralty court does not have jurisdiction to arrest cargo on board a ship for an unrelated claim.

In 2016, the Supreme Court of India in the case of *CIT v. Trans Asian Shipping Services (P) Ltd.*⁸ observed that whenever there is a question of a tonnage of ship and the said tonnage is to be determined, it has to be in accordance with the valid certificate indicating its tonnage and it is a compulsory obligation of the taxpayer to produce such a certificate. Nonetheless, the arrangement pertains only to purchase of slots, slot charter and the sharing of the break-bulk vessel. The requirement of producing a certificate does not apply when the entire ship is not chartered. Allowing the benefit of a tonnage tax scheme to the taxpayer, this Supreme Court decision may help the shipping companies to claim the benefit of a tonnage tax scheme for slot charter arrangements.

In 2016, in the case of *Union of India v. Sancheti Food Products Ltd.*, the Supreme Court,⁹ within the short compass of facts, justified the award of compensation for damage suffered by the vessels in question. This was because of the following contradicting and conflicting stands that delayed the registration of the vessel: Part XVA of the Act that deals with the registration

5 Commercial Notice of Motion (L) No. 1392 of 2018 in Commercial Admiralty Suit (L) No. 20 of 2018 – Order dated 25 September 2018.

6 Bombay High Court 17 September 2018.

7 SPJC 1 of 2018 – 10 August 2018 – Kerala High Court.

8 *CIT v. Trans Asian Shipping Services (P) Ltd* (2016) 8 SCC 604.

9 *Union of India v. Sancheti Food Products Ltd* (2016) 3 SCC (Civ) 390.

of 'fishing boats' was brought into the statute book in 1982 (to include seagoing shipping vessels) and was pursuant to the exercise of fresh legislation for the registration of vessels; whereas the Rules of 1960 that governed the parameters of registration were not substituted by this amendment made to the MSA – the relevant statute dealing with registration of vessels.

In 2015, in the case of *Petromarine Products Ltd v. Ocean Marine Services Co Ltd*,¹⁰ the Supreme Court held that when a suit is filed before court having jurisdiction over the vessel in question and that court passes order for arrest and sale of the vessel pursuant to which sale is effected, vessel and sale proceeds become custodial legis of that court and no subsequent proceedings by any other person interested can be maintained before another court without leave of jurisdictional court (Section 3(15) of the MSA). Because the vessel was berthed at Madras Harbour, the Madras High Court alone had the jurisdiction to enter any claim against the subject vessel as per the aforementioned Section. The arrest of the vessel by the Madras High Court being the first arrest, the vessel and the sale proceeds are *custodia legis* of the said court.

Aviation

In March 2015, in the matter of *Awaz 39423 Ireland Ltd and Ors v. Directorate General of Civil Aviation and Ors*, the Delhi High Court ordered the latter to deregister six of SpiceJet's Boeing 737 planes, following the termination of lease agreements. Babcock and Brown Aircraft Management had also sought the return of six Boeing B737 aircraft and a payment of US\$100 million from SpiceJet for unpaid rent and maintenance costs. The court observed that the DGCA was obliged to deregister planes on receiving a request from a leasing company in accordance with the Cape Town Convention.

ii Developments in policy and legislation

Shipping

The highly ambitious 'Sagarmala' project, which was conceptualised in 2015, aiming to promote port-led direct and indirect development and to provide infrastructure to transport goods along the long coastline and the inland waterways to and from ports, quickly, efficiently and cost-effectively, has now been implemented.

As part of the Sagarmala project, more than 400 projects have been identified for implementation between 2015 and 2035 across the areas of port modernisation and new port development, port connectivity enhancement, port-linked industrialisation and coastal community development. Out of these, 199 focus projects are phased out up to 2019.

Some of the key initiatives already implemented under the Sagarmala project include:

- a port community system (PCS): PCS is a centralised single window platform, which serves as a message exchange gateway for port community stakeholders. It not only serves the purpose of improving efficiency of ports, but also provides a secure data exchange medium between ports and various related stakeholders. All the 12 major ports have been integrated with PCS;
- b replacing manual forms with web-based e-forms;
- c installation of scanners and radio-frequency identification (RFID) for gate automation;

10 *Petromarine Products Ltd v. Ocean Marine Services Co Ltd* (2015) 7 SCC 229.

- d* introduction of direct port delivery at select ports as a pilot project, which reduces dwell time of containers and improves cost efficiency; and
- e* automatic issue of delivery orders and launch of single-window interface for facilitating trade.

Shipyards have been accorded 'infrastructure' status, and accordingly, shipbuilders can now avail cheaper long-term financing for Indian shipbuilding and ship repair industry. Additional incentives such as income tax exemption for infrastructure development including ports and a 10-year tax holiday to enterprises engaged in developing ports have also been introduced. A 70 per cent abatement of service tax on coastal shipping brings the fares at par with road and rail. Additionally, central excise duty has been exempted on capital goods, raw materials and spares used for repair of ocean-going vessels. New shipbuilding, breaking and repair policy, in line with the international ship breaking code is expected to significantly increase the size of the shipping industry.

India and South Korea partnered up for the Maritime Summit 2018 held in Mumbai. The launch of the summit was in relation to the development of the shipping industry in India, including a focus on the idea of setting up new ports in India, coastal shipping etc. to promote the industry as well as to take better advantage of India's geographical location. In addition to the promotion of the shipping industry and the various opportunities in the Indian shipping and maritime sector, discussions between India and South Korea to initiate a partnership in relation to LNG development also took place during the 2018 summit.

The India Dry Bulk Cargo Summit has been scheduled for June 2019 in Mumbai. The conference is to focus on the economic development in relation to Dry Bulk Cargoes such as Coal, Iron Ore, Grain, Fertilisers, etc.

Inland waterways

India has a vast riverine system that lies underdeveloped and is underutilised for transportation of cargo. The Indian government has realised the potential of the inland waterways and has directed the Inland Waterways Authority of India (IWAI) to make riverine transportation in India a reality. There is an enormous focus on the development of 'inland waterways', and the IWAI is going full throttle on reviving the inland waterways. The development of these waterways opens up new opportunities for business, such as:

- a* supplying dredgers;
- b* barges and cargo-handling equipment;
- c* construction and management of terminals; and
- d* hydrographic services.

The India and Asian Development Bank (ADB) have signed a US\$375 million pact for the first phase of a planned 2,500-km East Coast Economic Corridor. The grant is in addition to US\$631 million in loans and grants that was approved by the ADB in September 2016 for the industrial corridor.

The Central Road Fund (Amendment) Bill, 2017 was introduced in the Lok Sabha on 24 July 2017 by the Minister of Road Transport and Highways, Mr Nitin Gadkari. The Bill seeks to amend the Central Road Fund Act, 2000. Under the 2000 Act, the fund can be utilised for various road projects including: (1) national highways; (2) state roads including roads of inter-state and economic importance; and (3) rural roads. The Bill provides that in addition to these the fund will also be used for the development and maintenance of national

waterways. The Bill defines national waterways as those that have been declared as 'national waterways' under the National Waterways Act, 2016. Currently, 111 waterways are specified under the 2016 Act as national waterways. The Bill is not currently in force and would only come into force after receiving presidential assent.

In 2018, the inland waterways Jal Marg Vikas Project, which was approved by the Cabinet Committee on Economic Affairs, was implemented with the investment and assistance of the World Bank to create the first waterway stretch, the National Water 1 (NW1). The completion of the project is expected to be in March 2023. This project is in relation to a fairway covering major districts along the Ganga River in India, which would enable better commercial navigation in a cost effective and environment friendly manner.

The National Institution for Transforming India (NITI Aayog) has made recommendations to streamline the regulatory structure in relation to the Inland Waterways. The recommendations are in relation to maintaining and developing deeper stretches of river for year-round navigation, as well as to relax restrictions for vessels in relation to river-sea movement. In addition, the recommendations also include better facilitation with regard to the movement of goods to neighbouring countries.

Port-led developments

In March 2018, a revised Model Concession Agreement was approved to make port projects more investor-friendly and make investment climate in the sector more attractive. In terms of maritime cargo handled in the country, major ports registered a growth of 4.77 per cent during FY18 at 680 million tonnes.

Project UNNATI has been started by the government of India to identify the opportunity areas for improvement in the operations of major ports. Under the project, 116 initiatives were identified out of which 89 initiatives have been implemented as of August 2018.

The Ministry of Shipping has initiated 'Project Green Ports', which focuses on sustained growth from an environmental perspective. It aims to install 160.64 megawatts of solar and wind-based power systems at all the major ports across the country.

To improve port-rail connectivity, the Ministry of Shipping set up the Indian Port Railway Corporation Limited (IPRCL) to link all ports to the railway network across the country. The IPRCL is currently conducting a feasibility study for implementation of seven projects connecting various ports. The projects are deemed to be implemented by relevant central ministries, state governments, ports and other agencies through public-private partnerships. Around 20 projects were taken up for consideration across eight major ports, out of which 11 projects total US\$1.13 billion.

India has also moved towards using technology and other digital platforms to simplify processes. Transfer of conventional activities to digital platforms, use of technology for moving cargo and simplification of processes have been done to promote business and facilitate ease of doing business. Steps taken include the following:

- a RFID system installed in 11 major ports to enhance security, remove bottlenecks for seamless movement of traffic across Port gates. The RFID system automatically identifies the trucks and drivers without the need to stop at the port gates for manual checking.
- b DMICDC's logistics databank system for tracking and tracing movement of EXIM containers in the major ports, thereby enabling the consigners and consignees to track the movement of the containers from portal.

- c* Direct port delivery and direct port entry enable direct movement of containers from factories or port without intermediate handling requirements, thus saving costs and time.
- d* Installation of drive-through container scanners to save time at major ports.
- e* Reducing paperwork through issuance of e-delivery orders, e-invoice and e-payment across all the major ports. Digitisation of processes has considerably reduced the processing time.
- f* Upgradation of the centralised, web-based PCS to provide global visibility and access to the central database to all its stakeholders through internet-based interfaces.

Aviation

The civil aviation industry in India has emerged as one of the fastest growing industries in the country during the last three years. India is currently considered the third largest domestic civil aviation market in the world and is expected to overtake the UK to become the third largest air passenger market by 2024. India's passenger traffic grew at 16.52 per cent year on year to reach 308.75 million in FY18.

Recently, the FDI regulations have been relaxed to permit foreign airlines to invest up to 49 per cent in the paid-up capital of Air India. Such investment should however be subject to, among others, the condition that the investment should be made under the government approval route and the 49 per cent limit will subsume FDI and Foreign Institutional Investor's or Foreign Portfolio Investor's investment.

The first Global Aviation Summit 2019 was held by the Ministry of Civil Aviation in collaboration with the Federation of Indian Chambers and Commerce Industry on 15–16 January 2019 in Mumbai, Maharashtra. The Summit focused on the celebration of 'Flying for All' and to provide a platform to the aviation fraternity to showcase the challenges of the sector in the newly developing growth spots, as well as to understand how the technology-driven innovations will change air travel in the future.

iii Trends and outlook for the future

Shipping

The government of India aims to make the country the first in the world to operate all 12 major domestic government ports on renewable energy. The government plans to install almost 200 MW wind and solar power generation capacity by 2019 at the ports. The energy capacity could be ramped up to 500 MW in future years.

Increasing investments and cargo traffic points towards a healthy outlook for the Indian ports sector. Providers of services such as operation and maintenance, pilotage and harbouring and marine assets such as barges and dredgers are benefiting from these investments.

Coastal shipping is being encouraged by the government as it is expected to drastically reduce the cost of logistics. Coastal shipping has been growing faster than overseas trade shipping and is expected to continue its growth voyage over the next five years. As per government data, Indian ports handled 234 million tonnes of coastal trade cargo in 2017–18, recording a growth of 16 per cent over the previous year. The coastal trade cargo has grown at an average of 14.2 per cent annually between 2014 and 2018. Benefits offered to coastal shipping currently are:

- a* reduced GST on bunker oil for vessels used for coastal trade;
- b* 40 per cent discount on cargo and vessel related charges;

- c 80 per cent discount given on vessel and cargo related charges for two years to Ro-Ro vessels used for transportation of vehicles;
- d priority berthing of coastal ships without any charge with the introduction of green channel clearance for faster evacuation of coastal cargo at major ports;
- e allowing the reimbursement of freight subsidy on primary movement of subsidised urea; and
- f development of coastal shipping is dependent on last-mile connectivity for efficient movement of cargo from ports to the industrial units. Measures being taken under Sagarmala project are expected to address these issues.

The cruise industry is expected to generate both employment and foreign exchange if the right infrastructure is provided to this sector. The government has introduced the following steps to attract cruise ships to Indian shores:

- a port charges have been reduced to US\$0.35 per Gross Registered Tonnage for first 12 hours of stay, and these charges will stay until 3 November 2020;
- b foreign flag cruise ships carrying passengers can call at Indian ports without obtaining a licence from the DGS until 5 February 2024; and
- c cruises with Indian ports as their home port will not be levied charges for priority, ousting and shifting.

As a result, the number of cruise vessels visiting the five major ports (Mumbai, Goa, Mangalore, Cochin and Chennai) has increased by 75 per cent in 2017–18 versus 2014–15. The number of cruise passengers has increased from INR 82,600 in 2013–14 to INR 190,000 in 2017–18.

Aviation

In a recent International Air Transport Association report, India has been appraised for being the world's fastest growing domestic aviation market. As per the report, India is expected to be the third largest aviation market by 2025, in volume. It has been predicted that the Indian market would be catering for nearly 478 million passengers by 2036, which would bring the sector into its booming stage. Such trajectory growth has mostly been fuelled by favourable government policies and initiatives such as UDAN and NextGen Airports for Bhasat (NABH) Nirman, which aim to connect 56 unserved airports and 31 unserved helipads. However, in contrast to such encouraging predictions, the Centre for Asia Pacific Aviation has predicted a consolidated industry loss of approximately US\$460 million in financial year 2019. Some of the major airlines in India such as Indigo and Jet Airways have been found to be struggling in debt reduction and have reported losses in multiple quarters of the financial year. Various airlines have also been delaying accepting possession of new fleet and have reported higher interest payments for such rescheduling.

India's aviation industry is largely untapped, with huge growth opportunities, considering that air transport is still expensive for the majority of the country's population, of which nearly 40 per cent is the upwardly mobile middle class. The industry stakeholders should engage and collaborate with policy makers to implement efficient and rational decisions that would boost India's civil aviation industry. With the right policies and relentless focus on quality, cost and passenger interest, India would be well placed to achieve its vision of becoming the third-largest aviation market by 2025.

JAPAN

*Kosuke Shibukawa and Ryuichi Sakamoto*¹

I INTRODUCTION

i The transport finance industry

Aviation is one of the few growing fields for financiers, because the market has recently opened up to low-cost carriers. Japanese financiers (including banks, leasing companies and trading companies) have ambitiously started to participate in aviation finance or investment focusing on the profits brought by aeroplanes themselves rather than the credit capabilities of airlines.

Unlike the aviation industry, there has been fierce competition in the shipbuilding field within Southeast Asia, especially in Japan, China and Korea,² which is because there are many ship types,³ sizes⁴ and quantities. Since the global financial crisis, order numbers for new vessels have reduced. However, in conjunction with the recent development of the shipping market, the number of new ships and finance transactions has increased in Japan.

In the rail business, the Japan Railway Construction, Transport and Technology Agency (JRJT)⁵ issued a 'green bond' for the construction of train lines in east Kanagawa in November 2017, of which fitness for the guidelines on green bonds was officially confirmed for the first time by the Ministry of the Environment.⁶

In the general area of transport finance, the Basel Capital Accords have required financial institutions to be careful in examining financing. Liquidation of credit receivables, such as securitisation of aviation finance or loan participation in ship finance, has gradually increased. Basel III, which deals with liquidity coverage ratios (LCRs) and net stable funding ratios (NSFRs), may also have a certain influence on the field of transport finance.

ii Recent changes

Aviation

As a result of amendments to the tax regime in fiscal year 2005, all the benefits gained from leveraged leases in aviation were removed; thus, the operating lease has become the most frequently used structure for aviation finance. Although there are a large number of varieties in the structure of the operating lease, from the perspective of investor participation, it is

1 Kosuke Shibukawa is a partner and Ryuichi Sakamoto is an associate at Nishimura & Asahi.
2 Examples of this include CSSC, Daewoo, Hyundai, Imabari, Samsung and SCIC.
3 Examples of this include bulk carriers, container ships, oil tankers, chemical tankers and reefer ships.
4 Examples of this include Handysize, Panamax and Capesize.
5 An independent Japanese administrative institution.
6 Mizuho Securities Co, Ltd, 'Capital Market Letter', 18 January 2018.

typically the case that: (1) the investors directly own the aircraft; (2) a voluntary partnership set up by the investors, which usually consists of more than three special purpose companies, owns the aircraft; or (3) a silent partnership is set up and the operator of the partnership, which is usually a special purpose Japanese corporation, owns the aircraft. Among these, the structure of either a silent partnership or a voluntary partnership is often utilised. Further, when the lease and loan are back to back and a call option by the lessee to purchase the aircraft is then also granted under the lease agreement, it is called a JOLCO.⁷ The JOLCO structure is often used by domestic and international airline companies to maintain their fleets.

In recent years, aviation financing through Japanese enhanced equipment trust certificates – securitised products backed by security interests created in aircraft assets – has been implemented, where a trust governed by the Trust Act of Japan obtains funds by issuing trust beneficial interests to Japanese financial institutions and then purchases aircraft from manufacturers and leases them to airlines.

Shipping

Because of the weakness of the Japanese yen against foreign currencies, the financial condition of domestic ship-owners has recently improved as financiers have begun to focus on ships as investments with a good rate of return. In the context of ship finance, JOLCO transactions are often adopted as a financial option for ship operators. Thus, the structure is, like aircraft JOLCO, either that of a silent partnership or a voluntary partnership, and ownership of the vessel is held by the operator or the voluntary partnership. A call option by the charterer to purchase the vessel is granted under the charter agreement, and the charter and loan are back to back. In recent years, the number of cross-border JOLCO transactions – where ships are owned by Japanese partnerships or special purpose vehicles (SPVs) and then chartered to non-Japanese shipping companies – has been increasing. Meanwhile, with almost the same structure, JOLCO transactions in relation to containers are also being set up by Japanese or non-Japanese shipping companies, lease companies and financial institutions.

Under Annex VI of The International Convention for the Prevention of Pollution from Ships, 1973, as modified by the Protocol of 1978 relating thereto (MARPOL), vessels operating in emission control areas may, as of 1 January 2015, only burn bunker oil with a maximum 0.1 per cent sulphur content, so there is a demand for liquefied natural gas (LNG) as fuel in these areas. The Japanese government and shipping industry are trying to put LNG-fueled vessels into practical use, which will also lead to a greater demand for LNG tankers and LNG-bunkering vessels. In 2017, the world's first LNG-bunkering vessel, *Engie Zeebrugge*, jointly owned by Nippon Yusen Kaisha, Mitsubishi Corporation and FLUXYS SA, was completed at the shipyard of Hanjin Heavy Industries and Construction. It is likely that finance for LNG vessels and projects will become progressively more attractive.

An amendment to the Commercial Code of Japan in relation to transportation law and maritime law will come into effect on 1 April 2019. With respect to ship finance transactions,

7 In cases where the lessee exercises the call option, the investors can receive a full refund of their investments, but if the lessee does not exercise the call option, the operator should sell the returned aircraft to a third party and the sale price should be applied to the investment refund. At this point, the investors should take the risk associated with the residual value of the aircraft (however, it is the investors taking a risk on the residual value of the aircraft that is the basis from which the investors can receive benefits from the depreciation of the aircraft).

in accordance with the amendment, certain types of claims, such as accrued freight charges and expenses of preservation after judicial sale or at last port, will not be covered by maritime liens and 'time charter agreement' will be newly defined.

II LEGISLATIVE FRAMEWORK

i Domestic and international law and regulation

Aviation

Broadly, the Aviation Act covers the relevant issues of aircraft safety, air navigation, as well as proper and rational management of the air transport business.⁸

The person who has the ownership right of an aircraft may apply for registration of that right. Upon registration of an aircraft with the aircraft register, the aircraft becomes eligible for a certificate of airworthiness from the Japanese aviation authority and operation in Japan. Ownership of an aircraft can be perfected upon registration in Japan,⁹ but an aircraft owned by (1) persons who do not have Japanese nationality; (2) foreign governments, foreign public bodies or any other similar associations; (3) legal persons or other associations established under foreign law; or (4) a legal person whose representative falls within one of the above categories, or of which one third or more of the directors or the people who hold voting rights fall into one of the above categories, and those under foreign state flags, may not register.¹⁰ A party that intends to participate in the air transportation business must also obtain permission from the Ministry of Land, Infrastructure, Transport and Tourism.

The 2006 Cape Town Convention on International Interests in Mobile Equipment has not been ratified in respect to mortgages or liens on aircraft, so the domestic Aviation Mortgage Law is applicable.

Shipping

There are several Japanese laws broadly covering the marine transportation business in relation to ships and vessels. For example, the Ships Act stipulates the requirements for owners of Japanese-flagged vessels, the Marine Transportation Act sets the rules on the marine transportation and ship chartering business, the Mariners Act sets the rules on the working conditions for crew on Japanese-flagged vessels, and the Ships Safety Act stipulates the standards on navigation of vessels for the safety of human life.

Under the Ships Act, there are statutory requirements for owners of Japanese-flagged vessels, which limit ownership to: (1) the Japanese government or public authorities; (2) Japanese nationals; or (3) legal entities incorporated under Japanese law of which the representative director and two-thirds of the executive officers must be Japanese nationals. There are, however, no particular regulations applicable to owners of foreign-flagged vessels, who are always subject to the law governing the registration of the vessels.

Registration of ownership or mortgages on Japanese vessels takes place in accordance with the Ships Act,¹¹ the Ship Registration Rules, or the relevant regulations. In terms of maritime liens and ship mortgages, which concern financiers, Japan has ratified neither the

8 Section 4 of the Aviation Act.

9 Section 3-3 of the Aviation Act.

10 Section 4 of the Aviation Act.

11 The Ships Act regulates qualification, registration and national certification for Japanese vessels.

International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages of 1967 nor the International Convention on Maritime Liens and Mortgages of 1993. Enforcement of liens and mortgages on ships is dealt with under the Civil or the Commercial Code.

Chapter 3 of the Commercial Code (maritime law) broadly covers commercial transactions or issues concerning shipping, maritime and admiralty.

Rail

According to the Railway Business Act,¹² parties who enter into the railway business must obtain permission from the Minister of Land, Infrastructure, Transport and Tourism. Before 1999, the railway business was licensed by the government only taking into consideration supply and demand, but competition was subsequently introduced into the field.

The Railway Mortgage Act makes provisions for mortgages secured on complete railway facilities incorporated as 'foundations'.

ii Specific practices

Aviation

Because of the requirements for ownership registration as described in Section II.i above, a structure has been developed in Japan to allow an aircraft to be registered in Japan while the economic ownership thereof remains with a foreign entity. Under this structure, the aircraft is sold by a foreign entity, usually to a Japanese special purpose company (the Japanese owner) that is wholly owned by a local Japanese entity (usually a Japanese trading company). This satisfies the nationality and corporate structure requirements of the Aviation Act. The aircraft is registered in the name of the Japanese owner, and all the rights to possess and use the aircraft are transferred back to the foreign owner pursuant to a conditional sale arrangement. Additionally, the Japanese owner must transfer the ownership rights of the aircraft to the foreign owner upon the foreign owner's exercise of its repurchase option in exchange for payment of a nominal sum. The Japanese owner also grants a priority mortgage in favour of the foreign owner to secure the obligation to transfer the ownership.

Shipping

Japanese maritime law was originally intended to cover Japanese-flagged vessels owned by Japanese owners, and there have been many disputes over the issues of whether mortgages on foreign-flagged vessels are recognised, and whether liens on foreign vessels are created for credit or claims brought under contracts governed by foreign law. This is a matter of international conflict law, and no clear answer has yet been supported by Japanese statute.

Rail

In the established Japanese system, the JRJT directly finances each railway operator, upon obtaining funds from a variety of financial resources.¹³ Railway operators obviously prefer to undertake railway construction or provide services in a stable investment environment so

¹² Section 3 of the Railway Business Act.

¹³ The JRJT obtains certain funds from commercial banks, such as by way of syndicated loan schemes. According to recent information from the JRJT, it obtained finance by way of syndicated loans, for example, in March 2019, ¥55.3 billion for a maximum of four years arranged by Mizuho Bank, Ltd.

that the investment is beneficial in the long term. Railway facilities are leased or assigned to railway operators by the JR TT, which retains ownership. Finance for train construction is usually obtained by debt finance, vehicle trust, lease or leveraged lease.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

According to the Banking Act, the prime minister may set the levels of capital adequacy for financial institutions; under this Act, the minimum capital adequacy ratios were set at 8 per cent for financial institutions subject to international standards and at 4 per cent for financial institutions subject to domestic standards as stipulated in the Pronouncement of the Financial Services Agency of 27 March 2006, in accordance with Basel I and II.

The Financial Services Agency published the revised pronouncement following Basel III: (1) of the international standards for financial institutions on 30 March 2012, effective from 31 March 2013; and (2) of the domestic standards for financial institutions on 8 March 2013, effective from 31 March 2014.

The LCR under Basel III was implemented on 31 March 2015 with a required level of at least 60 per cent, and as a result of being raised in a phased manner, the required level reached 100 per cent as of 1 January 2019. The NSFR, which requires financial institutions' medium to long-term funding to be covered by their medium to long-term financial resources, will be introduced on 31 March 2019, and thereafter financial institutions having foreign branches will need to maintain an NSFR of not less than 100 per cent.¹⁴

In the meantime, the Deposit Insurance Act, which secures funds of depositors in the event of a bank's failure under the management of the Deposit Insurance Corporation, was revised on 12 June 2013.

ii Supervisory regime

If a non-Japanese person intends to make a loan to a Japanese ship or aircraft owner set up under a JOLCO transaction, such person, in general, needs to fulfil one of the following conditions: (i) to establish a joint stock corporation in Japan and cause it to obtain a permission under the Banking Act; (ii) in the case where the person is an authorised foreign bank, to open a branch in Japan and cause it to obtain a permission under the Banking Act; or (iii) to complete a registration as a Money Lending Business under the Money Lending Control Act.¹⁵

14 Yuki Kanemoto 'Publication of Draft Pronouncement Regarding Net Stable Funding Ratios', Daiwa Institution of Research on 20 July 2018.

15 Japanese financial regulations are quite complicated, and there is a grey area as to whether such non-Japanese lenders actually need to obtain permission or registration set out above under the respective Japanese financial laws. Non-Japanese lenders should consult with a Japanese law firm specialising in cross-border financial transactions before participating in lending to Japanese borrowers.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

Ships

In many cases, newly built ocean-going vessels are registered in Panama or other tax-haven countries¹⁶ and are owned by SPVs established there, and below we outline examples of foreign-registered vessels. The finance schemes for such vessels depend on the laws of the countries in which they are to be registered, as the enforceability and effect of the security interests can be governed by such laws. There are two major schemes that are used to finance these vessels: ship-owner finance schemes and JOLCO schemes.

Under a ship-owner finance scheme, the vessel is owned by an SPV established and controlled by the ship-owner, the financier makes the loan to the SPV and the loan is guaranteed by the ship-owner and secured by the vessel mortgage, insurance assignment and charter hire assignment. Typically, the following agreements are prepared:

- a* a loan agreement between the loan financier and the SPV;
- b* a loan guarantee between the loan financier and the ship-owner;
- c* a mortgage agreement between the loan financier and the SPV;
- d* a charter hire assignment between the loan financier and the SPV; and
- e* an insurance assignment between the loan financier and the SPV.

Under a JOLCO scheme, the vessel is purchased from the ship operator by an SPV established in a flag of convenience country and controlled by a leasing company, which then becomes the registered owner. The registered owner SPV then sells the beneficial ownership of the vessel on an instalment sale basis to an SPV established under Japanese law and also controlled by the leasing company and obtains funds to purchase the vessel through a loan from loan financiers and a silent partnership investment from Japanese investors. Further, the vessel is bareboat chartered from the Japanese SPV to the ship operator (or its SPV). The loan is secured by the vessel mortgage, insurance assignment and charter hire assignment or other security interests. For a JOLCO scheme, typically the following agreements are prepared:

- a* a loan agreement between the loan financier and the Japanese SPV;
- b* a bareboat charter agreement between the Japanese SPV and the ship operator;
- c* an instalment sale agreement¹⁷ between the registered owner SPV and the Japanese SPV;
- d* a silent partnership agreement between the investors and the Japanese SPV;
- e* a mortgage agreement between the registered owner SPV and the loan financier;
- f* a charter hire assignment between the loan financier and the Japanese SPV; and
- g* an insurance assignment between the loan financier and the Japanese SPV.

Rolling stock

Railway construction is characterised as public infrastructure development, even if it is operated by a private railway company. Railways are constructed by the JRJT and sold to each railway company on an instalment basis, and there is a railway mortgage system in place

¹⁶ However, some JOLCO transactions adopt Japan registered vessels.

¹⁷ The registered owner SPV sells the vessel to the Japanese SPV on an instalment sale basis under an instalment sale agreement, provided that the last instalment purchase amount, which is nominal, is not due until the charter of the vessel is terminated.

to secure such loans. Under this system, the railway, rolling stock, and any other facilities necessary for railway operations are treated as a monolithic property known as a 'railway foundation' to prevent railway facilities from being sold off in pieces by public sale.

So far, in most cases, rolling stock is self-financed and lease schemes have not been used often in Japan.

Aircraft

In general, there are a number of varieties of aircraft finance transactions; however, given the space constraints, we focus on two typical schemes: (1) where a foreign SPV has economic ownership of the aircraft and leases it to a Japanese airline; and (2) where Japanese investors, directly or through an SPV or partnership, have economic ownership of the aircraft and lease it to a Japanese or non-Japanese airline.

With respect to scheme (1) above, as described in Section II.ii above, to enable an aircraft to be registered in Japan while the economic ownership thereof remains with a foreign SPV, the aircraft must be sold by a foreign SPV to a Japanese SPV that is wholly owned by a local Japanese entity (usually a Japanese trading company). Meanwhile, the Japanese SPV sells back its beneficial ownership to the foreign SPV pursuant to a conditional sale arrangement¹⁸ but continues to hold the legal title to the aircraft during the lease period for registration purposes, and the Japanese SPV also grants a priority mortgage in favour of the foreign SPV to secure the obligation to transfer the ownership to the foreign SPV. This scheme also requires a lease agreement, an aircraft sales agreement, a participation agreement, a share pledge agreement and (in the case where loan finance is additionally obtained) a loan agreement, a mortgage agreement and a security assignment agreement for the loan financier. Please refer to the following breakdown:

- a* an aircraft operating lease agreement between the foreign SPV and the lessee;
- b* a (second priority)¹⁹ mortgage agreement between the Japanese SPV and the foreign SPV;
- c* an aircraft sales agreement between the foreign SPV and the Japanese SPV;
- d* a conditional sales agreement between the Japanese SPV and the foreign SPV;
- e* a share pledge agreement between the foreign SPV and the parent company of the Japanese SPV;
- f* (in case of loan financing) a loan agreement between the loan financier and the foreign SPV;
- g* (in case of loan financing) a first priority mortgage agreement between the loan financier and the Japanese SPV;
- h* (in case of loan financing) a security assignment agreement regarding lease and insurance receivables between the loan financier and the foreign SPV; and
- i* a participation agreement between, inter alios, the Japanese SPV, the foreign SPV, the lessee and, as the case may be, the loan financier.

18 The Japanese SPV sells the aircraft on an instalment sale basis under the conditional sales agreement, but the last instalment (usually a nominal amount) will not become due until the end of the lease to the operator.

19 If loan finance is additionally obtained, the lender holds the first priority mortgage and the foreign SPV holds the second priority mortgage.

With respect to scheme (2) above, as described in Section I.ii above, it is typically the case that the investors directly own the aircraft or a voluntary partnership or a silent partnership is set up and the voluntary partnership or the operator (usually a Japanese SPV) of the silent partnership (collectively, 'owner') owns the aircraft. In either case, the aircraft is leased to an airline (or its SPV), and a loan financier makes a loan to the owner and the loan is secured by the aircraft mortgage, assignment of insurances and lease receivables, and airframe and engine warranties, and typically the following agreements are prepared:

- a* a loan agreement between the loan financier and the owner;
- b* an aircraft operating lease agreement between the owner and the lessee;
- c* (in case of a silent partnership) a silent partnership agreement between the investors and the owner;
- d* a mortgage agreement between the loan financier and the owner;
- e* a security assignment regarding lease and insurance receivables between the loan financier and the owner;
- f* an airframe warranties agreement between the airframe manufacturer, the lessee, the owner and the loan financier; and
- g* an engine warranties agreement between the engine manufacturer, the lessee, the owner and the loan financier.

ii Enforcement

Ships

Ship mortgages may be established and registered in Japan only for ships registered in Japan. Ship mortgages may not be enforced against third parties unless they are registered under Japanese law. However, maritime liens on vessels arise with respect to claims for pilotage, towage, bunker expenses, crew wages, and salvage,²⁰ and also claims in connection with marine casualties such as collisions or oil pollution,²¹ and these have priority over ship mortgages.²²

Rolling stock

The Railway Mortgage Act provides the railway mortgage system. Under this system, railway mortgages should be placed on the railway foundation, which is the collateral railway facility, and may be registered.²³

Aircraft

The Aircraft Mortgage Act and Civil Execution Act provide the aircraft mortgage system, which is only available for aircraft registered in Japan. Under this system, aircraft mortgages may not be asserted against third parties unless they are registered.²⁴

20 Section 842 of the Commercial Code. However, as described in Section I.ii, claims such as accrued freight charges, expenses of preservation after judicial sale or at last port will no longer be covered by maritime liens in accordance with the amendment to the Commercial Code.

21 Section 95 of the Act on Limitation of Liability of Ship-owners.

22 Section 849 of the Commercial Code.

23 Section 2 of the Railway Mortgage Act.

24 Section 5 of the Aircraft Mortgage Act.

Effect of insolvency proceedings

There are three types of insolvency proceedings under Japanese law: bankruptcy proceedings pursuant to the Bankruptcy Act, civil rehabilitation proceedings pursuant to the Civil Rehabilitation Act, and corporate reorganisation proceedings pursuant to the Corporation Reorganisation Act. The object of bankruptcy proceedings is the dissolution of the company, while the purpose of civil rehabilitation proceedings and corporate reorganisation proceedings is reconstruction of the company. The requirement for use of corporate reorganisation proceedings is very restrictive (i.e., only a joint stock corporation is permitted to utilise these proceedings).

Mortgages on vessels or aircraft, security interests in railway facilities, and any other perfected security interests can be enforced outside bankruptcy proceedings and civil rehabilitation proceedings (however, with respect to civil rehabilitation proceedings, a claim for removal of security interests may be made by a bankruptcy administrator or a court order for stopping the exercise of security interests may be issued). On the other hand, with respect to corporate reorganisation proceedings, security interests are dealt with as secured reorganisation claims, and they can be exercised within the corporate reorganisation proceedings in accordance with the reorganisation plan.

In addition, with respect to mortgages on vessels or aircraft, not formal registration but provisional registration is often used because of the high charges of formal registration incurred in the registration process, and provisional registration reserves the priority order as a security right of the mortgage, subject to the condition that the provisional registration is transformed into a formal one. However, if insolvency proceedings commence in relation to a vessel or aircraft on which a mortgage is created but the transformation process from provisional registration to formal registration has not been completed, there remains a risk that the validity of the mortgage may be avoided by a court or trustee on the grounds that the registration of the mortgage is still a provisional one.

Further, certain types of lease agreements or bareboat charter agreements that include, for example, full pay-out clauses or those prohibiting intermediate termination may be interpreted as finance lease transactions, in which case, the lease transactions are dealt with like the above-mentioned secured reorganisation claims if corporate reorganisation proceedings are in progress. Additionally, in this case there is a possibility that repossession or disposal of the leased property will be restricted.

iii Arrest and judicial sale

Ships

Even if a vessel and mortgage are registered in a foreign country, the mortgagee may apply for arrest and judicial sale of the vessel by submitting documentation proving the existence of the mortgage on the vessel²⁵ to a court, as long as the vessel is in Japan. Usually, the mortgagee will get a court order to obtain the certificate of the vessel's nationality and any other documents necessary for its sailing before its arrival at a Japanese port; upon arrival, an enforcement officer will then confiscate the foregoing documents from the vessel so that it cannot sail from the port. Within five days of the documents being apprehended, the mortgagee must formally apply for commencement of the judicial sale of the vessel to the court that has jurisdiction where the vessel has been arrested. The court has the discretion to decide to commence the

25 It is usually a certificate of registered matters.

judicial sale proceedings, and then, upon the mortgagee's application, to appoint a trustee to manage the vessel until completion of the sale. By this stage, the mortgagee will have had to pay the advance anticipated costs and expenses for the proceedings, which amount will be returned out of the proceeds of the sale. For example, a mortgagee paid about ¥13 million in a case of judicial sale under a ship mortgage before the Hakodate District Court.²⁶ It usually takes about six months from the commencement of the judicial sale to distribution of dividends.

In addition to the length and high costs of the judicial sale process, taking into consideration that: (1) a vessel or aircraft is movable and it is necessary to check its location prior to applying to a court; (2) in case of a foreign registered vessel, procedures in the nation where the vessel is registered may also be required; and (3) negotiation with the lessee or charterer may be necessary because the compulsory arrest and judicial sale process has a material effect on the lessee's or charterer's rights or interests, a private sale process is taken in normal practice.

Rolling stock

The mortgage on a railway foundation is enforceable by auction or compulsory administration, at the mortgagee's choice.²⁷ If the mortgagee selects auction proceedings, the railway foundation will be sold to a winning bidder as a single property.

Aircraft

Basically, the arrest and judicial sale procedures for an aircraft are similar to those for a vessel. Thus, if a mortgagee applies to a court for enforcement of a mortgage through judicial proceedings, the mortgagee has to submit to the court documentation proving the existence of the mortgage on the aircraft. Further, the mortgagee may ask the court to issue a court order to obtain the certificate of registration of the aircraft and any other documents necessary to prevent the aircraft from leaving the parking apron.

Unlike in the case of a vessel, the enforcement procedure for an aircraft mortgage as stipulated in the Civil Execution Act is restricted to aircraft registered with the Japanese aviation authority; therefore, foreign registered aircraft should be subject to the enforcement procedure for ordinary movable assets. However, since such provisions are not meant to cover assets as large as aircrafts, it will be highly difficult to proceed with an arrest and judicial sale procedure for a mortgage on a foreign registered aircraft.

Further, as is the case with vessels, a private sale process is taken in normal practice rather than the compulsory arrest and judicial sale process.

V CURRENT DEVELOPMENTS

As it was confirmed that the amendment to MARPOL will take effect in January 2020, many vessel operators or ship-owners have started (or will start) equipping scrubbers for emission gases. Although scrubbers are strongly connected to a vessel, it may become a legal question

26 Yasumori Takase, 'Introduction of a judicial sale case based on a mortgage before the Hakodate District Court, 1941', *Kinyu Houmu Jijo* 116 (2012).

27 Section 40 of the Railway Mortgage Act.

whether ownership of the scrubbers installed by an operator, or a person other than the vessel owner, is automatically vested in the vessel owner or if it belongs to the operator, or other such person.

MALTA

Tonio Fenech and Christian Farrugia¹

I INTRODUCTION

The transport finance industry

Malta's strategic location at the centre of the Mediterranean Sea has always placed the international transportation industry as an area of particular focus for economic development, and the island is traditionally a hub of maritime activity between Europe, North Africa and the Middle East.

The development of a strong maritime infrastructure has been systemic and strategic for the island ever since it was governed by the Knights of Malta in the sixteenth to eighteenth centuries, and continued in the years of British dominance over the islands from the beginning of the nineteenth century. As a result, the maritime infrastructure in Malta has consolidated and diversified, with major transshipment, shipbuilding and ship-repair facilities, within famously safe natural harbours. Furthermore, the knowledge infrastructure available in the maritime field has developed over the centuries, and is widely respected in the artisanal, technical, professional and other fields.

The fact that Malta is a premier jurisdiction for asset finance is immediately evident when one considers the success of its ship and aircraft registers. After independence was gained in 1964, Malta considered it vital to have a voice in international maritime affairs that matched its strategic position, rather than its population size, and it soon became clear that this was best achieved by gaining the confidence of financiers to ensure that a large ship registry could be built. It is widely accepted that the main impetus behind the ship registry's continuing growth has been proactive legislative and regulatory action, starting with a comprehensive package introduced in the late 1980s. This started a trend, evidencing the priority given to the sector, which continues unabated.²

In the aviation field, Malta has sought to match its maritime success by carefully designing and implementing a legislative and infrastructural development policy over the past 16 years or so. This has led to the development of further aviation-driven infrastructure,

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2 As at the end of December 2018, the reported registered gross tonnage in the Malta ship registry was 77.2 million gross tons, ensuring that Malta remains the leading ship registry in Europe and the sixth largest in the world.

successfully attracting major international investment in aircraft maintenance and related sectors.³ The aviation register has also been successful,⁴ particularly after Malta ratified the Cape Town Convention and related protocol in 2010.⁵

Most aircraft and ships registered or operating in Malta are financed through international credit institutions. Few of these are present within the jurisdiction, but there is a strong presence of professional services providers specialising in asset finance.

II LEGISLATIVE FRAMEWORK

Domestic and international law and regulation

Shipping

A number of legislative instruments come into play in relation to the financing of vessels. The general rules on contract law, contained in Chapter 16 of the Laws of Malta (the Civil Code) may apply to various forms of finance documents, including loan and leasing agreements, where Maltese law is the governing law. Moreover, the Civil Code includes relevant provisions regulating certain types of security often required by financiers, including pledges, irrevocable powers of attorney and security by title transfer. The Civil Code also contains specific provisions on ranking of creditors, causes of preference and inter-creditor agreements.

The laws relating to companies, specifically Chapter 386 of the Laws of Malta (the Companies Act), and subsidiary legislation enacted under the Chapter 234 of the Laws of Malta (the Merchant Shipping Act),⁶ will also be relevant in some respects. The creation, maintenance, dissolution, winding-up and insolvency of companies is regulated by the Companies Act, and the aforementioned subsidiary legislation.

The registration and operation of vessels, as well as the creation and registration of mortgages, privileges, hypothecs and liens over vessels, is governed by the Merchant Shipping Act, which widely adopts Anglo-Saxon notions in this regard. The Merchant Shipping Directorate at Transport Malta, commonly referred to as the Malta ship registry, is responsible for the registration of vessels under the Malta flag and the provision of all aspects of the ongoing administration of Malta-flagged vessels, including the registration of mortgages over vessels. Registration of a mortgage under the Merchant Shipping Act provides a high degree of security to financiers willing to fund the purchase of ships and yachts. The nature and effects of Maltese mortgages are further discussed in later sections of this chapter.

Chapter 12 of the Laws of Malta (the Code of Organisation and Civil Procedure) is also highly relevant in the ship-finance context, in that it lays down specific remedies available to creditors and the various methods of enforcement, including arrest of ships, judicial sales by

3 Lufthansa Technik established major facilities in Malta in 2003, followed by SR Technics in 2010, among others.

4 The Malta National Aircraft Register stood at 298 'live' aircraft by the end of 2018. A total of 63 aircraft were registered during 2018, the highest amount of aircraft registered in a calendar year with the record number of 20 airliners, including seven widebody aircraft. One should also note that the number of registered aircraft has doubled since 2012.

5 The Convention on International Interests in Mobile Equipment was adopted in Cape Town, South Africa on 16 November 2001, and came into force on 1 March 2006. Following ratification, the Convention entered into force in Malta on 1 February 2011.

6 Subsidiary Legislation 234.42 – Merchant Shipping (Shipping Organisations – Private Companies) Regulations.

auction and court-approved private sales. Jurisdiction of the Maltese courts and the claims in respect of which a creditor may proceed by means of an action *in rem* are also identified in the Code.

In addition to the above, domestic private international law rules – also found in the Code of Organisation and Civil Procedure, as well as Regulation (EU) No. 1215/2015, which recently substituted the Brussels I Regulation – are also directly applicable and may be relevant to creditors depending on the multitude of factors that determine applicable laws and jurisdiction in relation to any particular matter.

Aviation

The Civil Code, Companies Act and Code of Organisation and Civil Procedure, as well as private international law rules, are also relevant in connection with aircraft, any aircraft-financing arrangement insofar as they govern general contract law, certain forms of security, limited liability companies, arrest and other enforcement procedures, including choice of law and jurisdictional issues.

Aircraft registration and various forms of security, including mortgages and other security interests over aircraft, are governed by Chapter 503 of the Laws of Malta (the Aircraft Registration Act), which, in 2010, revamped Maltese laws relating to aviation, effectively consolidating the laws on registration and security over aircraft into a single legislative instrument. The Aircraft Registration Act also implements the Convention on International Interests in Mobile Equipment, 2001 (the Cape Town Convention) and its Protocol, ratified by Malta in 2010 and amended further in November 2016.

The Aircraft Registration Act formally recognises modern ownership structures such as fractional ownership and ownership through trust structures besides facilitating aircraft leasing, while working hand in hand with relevant amendments to the Civil Code to create a comprehensive security regime.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The principal legislative instrument regulating the banking industry in Malta is the Banking Act,⁷ which is concerned with the licensing of credit institutions, while further catering for their ongoing regulation and supervision. The Capital Requirements Directive of the European Union (Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms) and Regulation No. 575/2013 on prudential requirements for credit institutions and investment firms are implemented into Maltese law by way of the same Banking Act, which is supplemented by a set of 19 Banking Rules issued by the Malta Financial Services Authority (MFSA) for this purpose. The MFSA is the local regulator of the banking industry in Malta, with the European Central Bank exercising its banking supervisory authority at a European Union level.

As a general rule, the Banking Act stipulates that all credit institutions must have effective measures in place to assess and maintain internal capital levels necessary to cover the various risks to which they are or may be exposed to in view of the banking services

⁷ Chapter 371 of the Laws of Malta.

rendered. The Banking Rules issued by the MFSA serve to specifically regulate the bank capital adequacy regime applicable to credit institutions and make reference to the capital requirements criteria that must be fulfilled by these institutions. These criteria are often represented by means of the capital requirements ratio, which expresses the credit institution's own funds as a proportion of risk-weighted assets and off-balance sheet items, as well as perceived risk-weighted assets in respect of operational and market risk. In accordance with Regulation No. 575/2013 as implemented by the Banking Rules here referred to, the minimum level of the capital requirements ratio is 8 per cent, subject to the power afforded to the MFSA to increase this minimum level as a licence condition. Without prejudice to the minimum level of capital requirements ratio, it is pertinent to mention that the Banking Act further provides that no organisation shall be granted a licence to act as a credit institution unless it has initial capital amounting to a minimum of €5 million, or an equivalent amount in another currency.

In addition to the above, local credit institutions must also ensure that they adhere to two relatively new liquidity standards, introduced by Regulation No. 575/2013 to safeguard against a situation where a banking institution has a shortage of liquid funds. Local banks, in fact, must also ensure compliance with:

- a* the liquidity coverage ratio – essentially banks must hold an amount of high-quality liquid assets capable of covering a 30-day stress period; and
- b* the net stable funding ratio – banks must ensure that long-term loans are funded from equivalent to long-term financing sources.

Financial leasing activities are licensed under and regulated pursuant to the Financial Institutions Act,⁸ which takes a broadly similar approach to the Banking Act. The Financial Institutions Act regulates activities such as financial leasing, but leasing activity in relation to ships or aircraft does not require a licence where the lessor is owned and controlled or exclusively funded by persons or entities as described in Annex II of the MiFID II Directive.⁹

ii Supervisory regime

Banks and other credit institutions in Malta are regulated and overseen by the MFSA. The Central Bank of Malta must also supervise the conduct and activities of the local banks as it is responsible for ensuring the financial stability of the same.

IV SECURITY AND ENFORCEMENT

i Shipping

The Merchant Shipping Act provides for three forms of security that may be created, by agreement or operation of law, over a vessel. A vessel may secure an obligation by means of: (1) a mortgage; (2) a general hypothec over all debtor's assets, including the vessel; or (3) a special privilege arising in terms of law.

A crucial feature of the rules on ships as security for debts is that ships constitute a particular class of movables whereby they form separate and distinct assets within the estate of their owners for the security of actions and claims to which the vessel is subject. In the

⁸ Chapter 376 of the Laws of Malta.

⁹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014.

event of bankruptcy of the owner of a ship, all actions and claims to which the ship may be subject shall have preference, on the said ship, over all other debts of the estate. In effect, this would mean that if, for instance, a ship owner has a number of creditors, each having various forms of security over various assets, a creditor having a mortgage over the ship would rank before all other creditors in respect of the ship, notwithstanding that the same creditor will rank after other creditors in respect of other assets.

Other than these three main forms, the Civil Code, Companies Act and other subsidiary legislation provide the framework for other forms of security commonly required by banks or other entities financing the acquisition or operation of ships, including, *inter alia*, assignments of rights and other receivables, pledges of shares, suretyship, together with such mechanisms as irrevocable powers of attorney, as well as security by title transfer.

The most common, and certainly one of the strongest forms of security available to lenders under Maltese law is the registered mortgage. A number of characteristics of the Maltese law mortgage make this form of security particularly attractive to lenders. Among these, the most salient are the following:

- a a registered mortgage is not affected by bankruptcy of the mortgagor or shipowner and the mortgage shall therefore have preference on the said vessel, over all other debts, claims or interests of any other creditor of the bankrupt;
- b a mortgage constitutes an executive title, allowing the creditor to proceed with enforcement tools without any requirement for judicial verification of the right being enforced. The creditor can therefore proceed directly to issuance of any warrants of arrest and proceed with the procedure for judicial sale by auction or private sale, including a court approved form of private sale; and
- c the Merchant Shipping Act gives mortgagees extensive and easily enforceable rights in the event of a default of the debtor.

The procedure for registering a mortgage is straightforward. The mortgage is drawn up on the statutory form and delivered to the Ship Registrar, who will make the appropriate entry, indicating the exact time of registration, in the register kept for the purpose.

ii Aviation

Legislation governing security over aircraft largely follows that applicable in respect of ships. The Aircraft Registration Act was in fact modelled on the basis of the Merchant Shipping Act. There are, however, certain differences, resulting mainly from the implementation of the Cape Town Convention and related protocol on aircraft.¹⁰

As is the case with ships, the legal framework allows for various forms of security to be granted in favour of creditors, including, among others, mortgages, privileges, hypothecs, share pledges, assignment of rights, sureties and irrevocable powers of attorney. The two main forms of security over aircraft are the registered Maltese mortgage and the international interest under Cape Town Convention.

The registered mortgage over aircraft shares many of the features applicable to mortgages over ships. The aircraft is a separate asset within the estate of the owner, and is unaffected by bankruptcy of the owner. Furthermore, it constitutes an executive title and affords the mortgagee various rights enabling expeditious enforcement.

¹⁰ The Cape Town Convention is implemented through Articles 45 et seq., of the Aircraft Registration Act.

The registration procedure is also similar to that for registration over vessels, with the mortgage being recorded on a statutory form and delivered for registration in the National Aircraft Register.

iii Financing of contracts

Shipping

A mortgage may also be registered over a vessel under construction. Banks and other institutions financing new buildings, however, must be aware that Maltese law favours the shipbuilder by imposing a possessory lien in the shipbuilder's favour over the vessel. This entitles the shipbuilder to retain possession of the ship until all debts due to the shipbuilder have been paid. A debt secured by a mortgage will rank after the debt secured by the statutory lien in favour of the shipbuilder. Similarly, any ship repairer or other creditor into whose care and authority a ship has been placed for the execution of works or other purposes shall also have a possessory lien over the relevant ship.

Aviation

A possessory lien is also granted *ex lege* to any aircraft repairer, aircraft manufacturer or any other creditor into whose authority an aircraft has been placed for the execution of works or other purposes.

iv Enforcement

Under general principles of Maltese law, creditors seeking to enforce their rights will generally institute court proceedings by sworn application. Once judgment is given in favour of the creditor, the latter may use any of the warrants available at law, including, *inter alia*, a warrant of arrest, seizure, or a garnishee order, to recover the relevant amount due from the assets of the judgment debtor. Such enforcement driven measures are also available as provisional remedies even prior to filing court proceedings, provided that the relevant filings follow thereafter.

Shipping

A creditor having a registered mortgage over a ship (or aircraft), on the other hand, will be in a significantly more advantageous position, in that a registered mortgagee enjoys extensive and easily enforceable rights to recover amounts due, including self-help remedies, such as the right to take possession of or sell the ship without any requirement for judicial involvement. Typically, however, an executing mortgagee would obtain an executive warrant of arrest of the vessel and request a judicial sale by auction or a court approved private sale thereof. Where the mortgage is not for an amount that is set, liquid and due, the mortgagee can easily ensure executive title status by means of an affidavit specifying the sum due at the time of enforcement, served on the mortgagor.

Where the mortgagee opts for a court-approved private sale of the vessel,¹¹ the creditor would seek court approval of the sale for a determined price, and must include the name of the identified buyer besides submitting appraisements by two independent and reputable valuers. The creditor must also in such case adduce evidence that the private sale is reasonable in the circumstances and in the interest of all known creditors. A court approved private sale

11 Article 358 et seq., Chapter 12 of the Laws of Malta.

is often the preferred option, because it provides for a more certain outcome in terms of price obtained. Article 364¹² also provides title to the ship for the purchaser, which is free from all privileges and encumbrances. All other claims or demands against the ship (or aircraft) existing at the point of sale may thereafter be enforced only against the proceeds of sale.

The Merchant Shipping Act also contains provisions regarding ranking of creditors. A debt secured by a mortgage ranks in preference to all other claims other than the following specified privileged claims: (1) tonnage dues; (2) wages and expenses for assistance, recovery of salvage and for pilotage; (3) wages of watchmen and related expenses; (4) rent of warehouses; (5) expenses for preservation of the ship; (6) wages due to master, officers and members of the vessel's complement; (7) damages due to seamen for death or personal injury; (8) moneys due to creditors for labour, work, repairs prior to the departure of the ship on her most recent voyage; (9) ship agency fees due for the ship after her most recent entry into port; and (10) debts due to the ship repairer or shipbuilder for building or repairs. The registered mortgagee will rank prior to all other claims.

The significant advantage enjoyed by a registered mortgagee over other creditors was one of the factors that led to the introduction of the mortgage as a legal concept in Maltese law for ships and aircraft more than 40 years ago, in the early 1970s. The resultant asset finance regime has in turn been a major factor underlying the success of the Maltese ship registry. Judicial practice has followed in kind as the Maltese courts have generally distinguished themselves in generally dealing with claims involving vessels as a form of security rather expeditiously, recognising that delay in such matters is often highly prejudicial to the parties involved.

Aviation

The holder of a registered mortgage over an aircraft is afforded self-help remedies under the Aircraft Registration Act that are similar to those available to a ship mortgagee. In addition, the Aircraft Registration Act lists two particular remedies that in the past were not clearly considered available to holders of mortgages over vessels: (1) the right to lease the aircraft to generate income; and (2) the right to receive any payment of the price, lease payments and any other income that may be generated from the management of the aircraft. There is also express mention of the fact that the said rights may be exercised without the requirement of seeking leave of the court,¹³ as well as an additional right to obtain the support of the court should the mortgagee find any hindrance in the exercise of its self-help remedies. Further recent legislative amendment provides for application of funds received by a mortgagee after enforcement, as well as for circumstances where vesting of any mortgaged aircraft in the mortgagee (or controlled entity) in or towards the satisfaction of secured obligations, after due notice, is possible.

Mortgagees may also enforce their rights by obtaining an executive warrant of arrest, leading to a judicial sale by auction of the aircraft, or by seeking a court-approved private sale, the latter two procedures being regulated under the provisions of the Code of Organisation and Civil Procedure.

12 Chapter 12 of the Laws of Malta.

13 The courts have confirmed that this is also the case in respect of holders of mortgages over ships, notwithstanding the lack of any express affirmation in the law – *Norddeutsche Landesbank Girozentrale v. Chemstar Shipping Limited*, Appell Civili Numru. 810/2011/1, 25 May 2012.

Furthermore, Malta is a party to and has fully implemented the Cape Town Convention and its Aircraft Protocol. Therefore, creditors secured by an international interest registered with the International Registry, may exercise all the remedies available under the Convention in satisfaction of their claim.

As in the case of ships, the Aircraft Registration Act also provides for the ranking of creditors depending on the type of claim. A claim secured by a registered mortgagee or by a charge in the International Registry ranks before all other claims except claims for judicial costs incurred in the enforcement of an executive title, as well as the following privileged claims: (1) sums due to the director general in respect of the aircraft; (2) crew wages; (3) debts due to the holder of a possessory lien for the repair or preservation of the aircraft; (4) expenses incurred for repair or preservation of the aircraft; (5) wages and expenses for salvage; and (6) debts secured by possessory liens.

v Arrest and judicial sale

Shipping

Ship arrests are governed by the Code of Organisation and Civil Procedure. The said Code lays down the procedure, conditions and rules relating to the issuing of a warrant of arrest of a sea vessel.

The Code distinguishes between precautionary and executive warrants of arrest. The former may be issued by any person, without the necessity of a prior judgment or other executive title, to secure *in personam* or *in rem* debts or claims, that could be frustrated by the departure of the ship. The precautionary warrant is issued and carried into effect on the responsibility of the person at whose request the warrant is issued. The claimant may therefore be liable for payment of damages and penalties where a warrant issued out maliciously. Once a precautionary warrant is issued, the applicant has 20 days within which to bring the action in respect of the right stated in the warrant.

An executive warrant of arrest, on the other hand, can be sought where the claimant already has an executive title, such as a judgment in its favour, or a registered mortgage. On demand for issue of an executive warrant, the court may, in its discretion, order the sale of the vessel, or fix a time limit within which the debtor must pay the amount due. On expiry of the time limit, the court is bound to order the sale if the debtor has not yet paid.

The fact that registered mortgages under Maltese law are considered an executive title enables the mortgagee to enforce directly through an executive warrant of arrest, without first having to seek judgment confirming that the debt is due. The mortgagee will only be required to serve the debtor with an intimation to effect payment by means of a judicial act, following which the creditor can directly seek a warrant of arrest to proceed with the sale of the vessel in settlement of the debt.

In proceeding with the arrest, the mortgagee files an application to the court containing the demand for the warrant to be issued. Once the court formally ratifies the request, the relevant executing officer of the court can exercise all such powers as are necessary to arrest the vessel. No opposition to the execution of any warrant is possible until the execution has been effected. The debtor is notified of the warrant and may bring an action for revocation of the warrant, if there is any reason valid at law for doing so.

It is possible, in certain cases, to arrest a sister ship under Maltese law. The Code of Organisation and Civil Procedure lists the claims *in rem* that may be brought against a vessel. It goes on to specify that in respect of a number of these claims, an action *in rem* may be brought against any vessel where the person who would be liable on the claim for an action *in*

personam, is, at the time the action is brought, the owner or beneficial owner of the relevant vessel. Therefore, where there is a right to bring an action *in rem* against a sister ship, the creditor of the claim may obtain a warrant of arrest over that ship, as security or in execution of that right.

The procedure for judicial sale by auction of ships is the ordinary procedure applicable to judicial sale of movables in general.¹⁴ The Court Registrar regularly publishes lists of judicial sales by auction in the local press, but the law provides that the debtor, creditor or any other interested person may further publicise the relevant auction at their own expense. Creditors may also bid for the vessel on *animus compensandi* or set-off terms, by registering their name prior to commencement of the auction and filing a sworn statement confirming certain details. The judicial auction is conducted by a public auctioneer,¹⁵ who has the right to demand that a person submitting an offer should be in possession of the necessary guarantees.¹⁶ A purchaser would be required to deposit the price in court within seven days of the date of final adjudication.¹⁷ Any creditor having a judgment in his or her favour or other executive title may bid *animus compensandi*, that is, in set-off of the debt owing to him or her. In such cases, the purchaser *animus compensandi* will not be required to deposit the price in court, unless the price exceeds the amount of the debt, in which case the purchaser would deposit only the surplus.

Delivery of the ship to the purchaser takes place upon the payment of the price or the approval of the set-off.¹⁸ However, the court may, in terms of Article 331(3) provide for immediate delivery of the relevant ship to the purchaser upon the latter putting up appropriate security to safeguard any claims of the parties to the procedure.

Aviation

Aircraft arrests are also governed by the Code of Organisation and Civil Procedure. The same rules regarding precautionary and executive warrants apply in respect of aircraft. The list of possible claims *in rem* against aircraft, however, are more limited than those that may be brought against a vessel. Nevertheless, a claim in respect of a mortgage or international interest is included in the list.

It should, however, be noted that the situation regarding arrest of aircraft differs from that of arrest of ships in that it is only possible to institute proceedings *in rem* against the aircraft in connection with which the claim arose, and not against other aircraft of which the person who would be liable on a claim *in personam* is the owner or beneficial owner. The procedure for judicial sale of an aircraft is practically identical to the same procedure applicable in respect of vessels and movables in general.

V CURRENT DEVELOPMENTS

i Recent cases

Some recent, significant court decisions in the field of asset finance, are listed below.

14 Article 313(1) of Chapter 12 of the Laws of Malta.

15 Article 319(1) of Chapter 12 of the Laws of Malta.

16 Article 319(6) of Chapter 12 of the Laws of Malta.

17 Article 328 of Chapter 12 of the Laws of Malta.

18 Article 331(1) of Chapter 12 of the Laws of Malta.

The recent *MY Indian Empress* case¹⁹ surrounded the enforcement of creditor rights over a super yacht, including mortgagee rights. A first judicial sale by auction ordered at the request of a service provider had been rendered ineffective, after the successful bidder failed to deposit the funds representing the successful bid. A successful judicial auction was later requested by the mortgagee, with particular requests that the court impose *a priori* conditions of eligibility for bidders. These included the necessity of showing guarantees for a threshold value or other evidence as to the bidders' ability to complete the purchase in support of their offers, together with evidence as to the lawful source of the relevant funds and other similar requirements.²⁰ The court upheld such demands, showing that it was willing to take a pro-active approach to further safeguard the integrity and reliability of a judicial auction process.²¹

The *MV Kay* case is of particular interest, as it arguably affords creditors additional remedy possibilities.²² The plaintiff (creditor) had a first-ranking mortgage registered in St Vincent and the Grenadines, which the court considered equivalent to a mortgage under Maltese law as it satisfied the requisite conditions for recognition, and, therefore, also constituted an executive title. The plaintiff, therefore, arrested the vessel, and the court exercised its discretion to allow the plaintiff a short period to repay the debt. In the meantime, the plaintiff filed an application for court-approved private sale of the vessel, rather than following through with the procedure that would have resulted in judicial sale by auction. The unusual feature in this case, however, was that the creditor sought to have the court approve its own acquisition of the vessel by way of set-off for amounts it had claimed, rather than a private sale to a third-party buyer. The court considered that the law imposed no restriction on who can be the purchaser in a court-approved sale, and therefore upheld the claimant's request. This judgment therefore allows mortgagees to proceed with acquiring the relevant vessel themselves, without going through the entire (more complex and costly) procedure of bidding *animo compensandi* in a judicial sale by auction.

In the aviation context, a recent case wherein the court applied and interpreted the provisions regarding the precautionary warrant of arrest of aircraft is the *Medilink International Air Ambulance Limited* case.²³ The court here once again removed doubt as to the nature of alternative security that would allow for release of the relevant aircraft to be put up by a party against whom the warrant of arrest is issued. The party requesting the revocation of the warrant had claimed that the alleged debtor had sufficient assets in the form of shares in a Maltese company that were shown to have a certain market value that would clearly cover the original demand that had led to the arrest. The court refused to accept this as sufficient security, highlighting that the relevant alternative security must be firm, clear and capable of being realised by the judgment creditor. The court also confirmed that security in the form of a bank guarantee would also be acceptable.

19 *Melita Power Diesel Limited (C2376) vs M/Y Indian Empress* (IMO No. 1006245), decided by the First Hall, Civil Court, 31 January 2019, Reference No. 911/2018.

20 *Melita Power Diesel Limited (C2376) vs M/Y Indian Empress* (IMO No. 1006245), decided by the First Hall, Civil Court, 31 January 2019, Reference No.911/2018.

21 *Fenech Tonio Av. Dott. Noe v. M/Y Indian Empress* (IMO No. 1006245), decided by First Hall, Civil Court on 25 September 2018, Reference No. 901/2018.

22 *Pacific Seaways Shipbuilding Inc v. il-Bastiment MV Kay*, decided by the First Hall, Civil Court on 18 February 2016, Reference No. 35/2016.

23 *Medilink International Air Ambulance Limited v. L-Arjuplan 9H-MCM MSN-0028*, decided by the First Hall, Civil Court on 5 October 2015, Reference No. 291/2015.

The approach adopted in cases such as the above highlights a judicial attitude that consistently favours clear certainty in the field of ship and aircraft finance, ensuring that principles enunciated in recognising security interests in mobile assets are developed consistently and predictably. This is yet another aspect of the Maltese asset-finance panorama that will continue to underscore the island's progressive development as a centre of expertise and excellence in the asset-finance field.

ii Developments in policy and legislation

Minor amendments to the Banking Act were introduced by virtue of Act XXXI of 2017, which was enacted on 22 December 2017. The amendments relate mainly to the inclusion of proper definitions that are to be attributed to certain terms used throughout the Act, while further establishing that a credit institution may, where necessary for the proper carrying out of its activities or for the fulfilment of its obligations, communicate information in its possession and that is related to the affairs of a customer or connected person to: (1) other members of the group of companies of which the same institution forms part and that carry out licensable activities; (2) any auditor engaged by the institution to carry out a compliance assessment or similar review in relation to any of the activities or risk management processes of the same institution; or (3) an outsourcing service provider in whose favour a credit institution has outsourced any of its activities, subject to all proper controls and safeguards.²⁴

Act LII of 2016, which was enacted on 29 November 2016, amends various pieces of legislation, mainly to better provide for the financing of aircraft engines (including the specific extension of *in rem* jurisdiction thereon and the possibility of arrest thereof). The amendments also provide for simplified insolvency procedures for aircraft companies,²⁵ thus further alleviating the position of preferred creditors.²⁶ In both aviation and maritime law, the legal regime continues to develop mainly through court interpretation and application of existing rules and regulations.

iii Trends and outlook for the future

A notable trend that has subsisted over the years, in both the aviation and maritime sectors, is the tendency towards an approach that favours creditors. This can be seen in legislation protecting and strengthening the position of creditors, as well as the stance adopted by the courts in enforcing creditors' rights, as explained in previous sections of this chapter. Meanwhile, the ship and aircraft registries remain attractive to numerous ship and aircraft owners for various reasons, as evidenced by the statistics regarding registry growth provided in Section I.i.

In light of this, there is a positive outlook for both aviation and maritime industries, with further growth expected in both registries, and continued refinement of the legal regime governing vessel and aircraft financing, through legislative and court action.

24 Article 34(6) of Chapter 371 of the Laws of Malta.

25 Defined as companies whose centre of main interests is in Malta or is registered in Malta and the sole asset of which is an aircraft or aircraft engines and other related assets.

26 This term refers to the holders of a mortgage, an international interest or a security interest, or trustees or agents for such persons.

MARSHALL ISLANDS

Norton Rose Fulbright (Marshall Islands Practice)

I INTRODUCTION

After more than three decades of United States administration under the United Nations Trust Territory of the Pacific Islands, the Republic of the Marshall Islands (the Marshall Islands) became a self-governing country with its own Constitution under a Compact of Free Association with the United States. The Compact came into force in 1986 and was renegotiated in 2003.

The Marshall Islands ship registry is the second largest ship registry in the world by deadweight tonnage, representing a significant number of the world's commercial shipping fleet. A growing number of business entities formed in the Marshall Islands are routinely used as corporate vehicles for shipping and non-shipping activities.

Owners, operators and lessors are choosing the Marshall Islands as the flag state for their vessels with increasing frequency. The Marshall Islands flag is widely accepted by financiers, which is crucial as the flag selected will determine the governing law of the mortgage over a vessel and financiers rarely (or never) refuse to finance on account of a counterparty's choice of Marshall Islands flag.

II LEGISLATIVE FRAMEWORK

Domestic and international law and regulation

Maritime, financial and legal centres worldwide have full access to the Marshall Islands registry through the international offices of International Registries, Inc.¹ The Marshall Islands Business Corporations Act (BCA) is modelled on the corporate laws of the United States.

Ownership

Ownership is critical to choice of flag. Under the Maritime Act (1990 as amended), entities incorporated under the Associations Law (including under the BCA and the Limited Liability Company Act) and any foreign maritime entity qualified under Division 13 of the BCA may register a vessel in the Marshall Islands.

¹ International Registries, Inc provides administrative and technical support to the Marshall Islands Maritime and Corporate Registries.

Type of vessel

For the more common types of commercial ships such as bulkers, tankers and container ships, the Marshall Islands will accept registration subject to the usual due diligence. Generally, the Marshall Islands does not place restrictions on the types of vessels it will accept and also has a number of fishing vessels and yachts on its registry. The maximum age limit for a Marshall Islands-flagged vessel is 20 years, at which point a pre-registration survey or waiver is required.

Registration

In the Marshall Islands, provisional registration is not a prerequisite to permanent registration, when the owner can obtain a permanent navigation licence. Full registration is permitted until the vessel is deleted and dual or parallel registration (subject to the rules of the other flag) is permitted. Deletion from the Marshall Islands Registry requires the owner to submit a written request for a certificate of permission to transfer. Demise or bareboat charter registration in the Marshall Islands is limited to two years or until the date of termination of the bareboat charter, whichever occurs first, and may be renewed every two years until the expiration of the bareboat charter.

Vessel-financing charters

Vessel-financing charters can be recorded in the Marshall Islands. Upon recording, the finance charter should be treated similar to a preferred ship mortgage and the lessor (as ship owner) should be granted the status of a secured party. In other words, the lessor (ship owner) should have the benefit of being treated in much the same way as a mortgagee is treated in relation to a Marshall Islands preferred ship mortgage. It is, however, worth noting that such structures are relatively new and untested and may be subject to challenge and possible re-characterisation.

Tax

Under Marshall Islands law, interest, dividends, royalties, rents, payments (including payments to creditors), compensation or other distributions of income paid by a non-resident Marshall Islands entity to another non-resident entity or to individuals that are not citizens or residents of the Marshall Islands are statutorily exempt from any tax or withholding provisions under the laws of the Marshall Islands. Almost all Marshall Islands special purpose companies (SPCs) are non-resident and are therefore exempt, and there are no withholding taxes levied on the repayment of loans (principal or interest or both) to non-resident lenders in relation to such SPCs.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

A foreign lender does not need to qualify to do business in the Marshall Islands to extend credit to non-resident Marshall Islands companies (as borrowers) secured on vessels registered under the Maritime Act. However, if foreign lenders wish to agree loans to a Marshall Islands resident borrower, they must meet the requirements under the domestic law relating to banking and business operations.

There is no central bank or other regulatory approval required under Marshall Islands law for non-resident Marshall Islands companies to borrow from financial institutions outside the Marshall Islands. The Maritime Act allows for the parties themselves to decide the currency in which the vessel financing is to be denominated.

ii Supervisory regime

The Marshall Islands has no exchange control regulations.

IV SECURITY AND ENFORCEMENT

i Security documents

Mortgage

There is no prescribed form of preferred ship mortgage, save for certain terms that need to be included in the mortgage to be regarded as preferred. The preferred ship mortgage is maintained in the main office of the Marshall Islands Maritime Administrator in the United States. As a matter of practical and logistical efficiency, flexibility and convenience, the preferred ship mortgage may be recorded by the Commissioner of Maritime Affairs and any deputy commissioners at any of its offices worldwide. The preferred ship mortgage needs to be in English and will require notarisation or acknowledgement by a special agent for the Marshall Islands. The mortgagees do not have to be resident in the Marshall Islands to benefit from a mortgage.

Finance charter

As referenced in Section II.i, under Marshall Islands law, a ‘financing charter’ is defined as ‘a contract in the form of a demise or bareboat charter, regardless of duration, between the documented owner and the finance charterer of the entire vessel, which contract is agreed by the parties to be or is determined in judicial or arbitral proceedings to create in favor of the documented owner a security interest in the vessel granted by the finance charterer’. For a financing charter to be recorded in the Marshall Islands, it must be dated, signed and acknowledged by the documented owner and the charterer, and must include the name and official number of the vessel, the names and addresses of the documented owner and the charterer, and the aggregate of the nominal amount of all charter hire payments and purchase option amounts payable (or which may become payable) under the charter, exclusive of any interest, indemnities, expenses or fees.

Share pledge

The pledge of shares (or membership interests) in Marshall Islands shipowners are normally established by the grant included in a pledge agreement and will be perfected by delivering the certificated shares (or interests) into the possession (or control) of the secured party, along with the undated and signed relevant ancillary instruments (e.g., director resignations and powers of attorney) or as otherwise required or desirable under the laws of the relevant jurisdiction.

Guarantee

A Marshall Islands corporation is permitted to guarantee the obligations of others, provided this furthers its corporate purpose, unless specifically limited by Section 16 of the Business

Corporation Act or in its articles of incorporation. If that is not the case and to avoid any ambiguity, doubt or issue, it is highly recommended that the Marshall Islands company obtains shareholder consent to the directors' resolutions. Without shareholder consent, a shareholder could challenge a transaction at a later date on the basis that it was not in furtherance of the corporation's corporate purpose, and the transaction could potentially be set aside. To address this risk, shareholder resolutions should be required as standard.²

ii Enforcement, arrest and judicial sale

The Marshall Islands adopted the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention) in 2007. Domestic legislation, in the form of the Uniform Foreign Money-Judgments Recognition Act also applies, and, as its name suggests, addresses the enforcement of foreign judgments. The Enforcement of Judgments Act and the Marshall Islands Rules of Civil Procedure (RPC) address the matter of enforcement generally.

Foreign arbitral awards can be recognised in the Marshall Islands. Once recognised, they can be enforced locally and this can include the right to seek to have a receiver appointed to take over the assets of the Marshall Islands company. It should be stressed at the outset that proceedings in the Marshall Islands must be seen and pursued in the context of an overall recovery strategy as it is unlikely that major assets will be located within the jurisdiction of the Marshall Islands courts.

To have an award recognised in the Marshall Islands, a number of steps must be taken, beginning with the filing of a complaint in the Marshall Islands court, which can be done electronically.³ Following this, a summons will be issued, stating the name of the parties and of the court, directed to the defendant and stating the name and address of the plaintiff's attorney, the time within which the defendant must appear and defend, and notifying the defendant that a failure to appear and defend will result in default judgment against the defendant, signed by the clerk and bearing the court's seal. A summons must be issued for each defendant to be served. The serving of the summons will be within 120 days of the filing of the complaint and must be served with a copy of the complaint.⁴ At this point the defendant has the option to answer or oppose the complaint and is able to raise affirmative defences, such as those listed in the RPC under Rule 12(b), which must be done within 21 days of receiving the summons. It may be at this stage that the Marshall Islands company would state that it opposes domestication of the arbitral award. A plaintiff may then file motion for summary judgment if he or she can show that the defendant has raised no genuine issue as to any material facts, and that the plaintiff is therefore entitled to judgment as a matter of law (a summary judgment). Once the arbitral award has been domesticated, it will be a judgment of the Marshall Islands courts and once a judgment is obtained, a demand for payment can be made and a successful party is not obliged to take enforcement steps. A successful party can obtain a judgment and make demands, for example, every six months or so and still maintain the right to commence enforcement at a later date.

2 See Section 16 of the BCA.

3 Pursuant to Rule 5(d)(3A).

4 The RPC has several requirements for service. The BCA, at Section 20–22, discusses service on Marshall Islands companies.

With the exception of vessels operating strictly domestically in the Marshall Islands, it is rare to arrest and foreclose a Marshall Islands-registered vessel or any foreign-flag-registered vessel under the jurisdiction of the Marshall Islands courts.

The Maritime Act provides that a preferred mortgage on a Marshall Islands-registered vessel may be enforced *in rem* in admiralty or in any foreign country in which the vessel is located and follows the laws and enforcement procedures of the country arresting the vessel.

iii Ranking of liens

Under the Maritime Act, a preferred mortgage should have priority over all claims save for the following:

- a* maritime tort liens for damage caused by the vessel;
- b* maritime liens for unpaid tonnage tax, fees, penalties and other charges arising under the Maritime Act or its implementing regulations;
- c* crew wages;
- d* general average;
- e* salvage (including contract salvage); and
- f* expenses and fees allowed and costs taxed by the court.

It should be noted that any maritime lien claim for necessities such as repairs, supplies, towage and drydocking that arose prior to the preferred mortgage registration should have priority over such preferred mortgage.

V CURRENT DEVELOPMENTS

i Recent cases

Supreme Court and selected High Court and Traditional Rights Court decisions can be accessed via the Marshall Islands judiciary website.

ii Developments in policy and legislation

Recently, the Marshall Islands adopted amendments to its Associations Law in regard to companies incorporated in the Marshall Islands in order to phase out bearer shares. The reasoning for the relevant amendments by the Marshall Islands Corporate Registry is to bring the Marshall Islands in line with the implementation of certain transparency requirements of the Organization for Economic Cooperation and Development in relation to inter-jurisdictional exchange of ownership information for tax compliance purposes.

iii Trends and outlook for the future

The Marshall Islands, with its balanced rules and regulations, has grown increasingly popular among shipowners over the past decade. The Marshall Islands is a widely accepted flag by financiers, who will ordinarily readily accept a Marshall Islands mortgage as collateral for a loan. With the rapid rise of vessels flagged in Marshall Islands, new laws, regulations and case law can be expected.

NORWAY

Jostein Moen and Christian B Østlie¹

I INTRODUCTION

i Shipping

Norway is a leading nation in the shipping industry, and has long traditions in the sector. Norway has a strong knowledge base in a highly competitive market. Norway ranks as the world's fifth largest shipping nation by fleet value, in 2017. The number of ships in the Norwegian-controlled foreign-going fleet has increased over the past two years, and stood at 1,788 vessels in October 2018.

Norwegian shipowners have a strong position within offshore supply, bulk, ro-ro and other dry cargo, as well as chemical, gas, shuttle and other oil tankers.

Norway offers a highly stable and favourable regulatory framework. The Norwegian International Ship Registry and the Norwegian tonnage tax regime are among the decisive factors that make Norway a popular shipping nation.

In the ship finance industry, DNB and Nordea are the main debt-finance providers, in addition foreign banks are both present and active, in particular with regard to syndicated loans. Furthermore, several niche players are active, and new banks are established with a particular focus on the maritime sector.

In recent years, the Norwegian bond market has seen a surge in issuances in the shipping sector, and has been a huge success. Bond issue, through the Nordic Trustee, is an available and highly liquid source of finance.

The Norwegian syndicated shipping project market, with a focus on sale and leaseback transactions, arranged by players such as Pareto, Clarksons Platou, Arctic, Fearnley, NRP and others, is also a well-functioning and liquid source of finance.

ii Aircraft

Norway is a small country, though it has a relatively active air traffic industry. Oslo airport is Norway's international hub with about 28.5 million passengers in 2018.

Scandinavian Airline Systems (SAS) and Norwegian Air Shuttle are the most sizeable airlines operating out of Norway. In addition, Widerøe has local presence, flying to 40 destinations in Norway. The oil and gas industry requires helicopter support operations. The Norwegian Civil Aircraft Registry had 816 aircraft and 282 helicopters registered at end of 2018.

¹ Jostein Moen is a partner and Christian B Østlie is a senior lawyer at Kvale Advokatfirma DA.

Most commercial aircraft are financed through foreign credit providers. To the extent Norwegian credit providers are involved, this is on a relationship basis, as opposed to being asset-driven deals.

iii Rail

The major passenger operator in Norway is NSB, which is state owned. The only other passenger operators of any size are Flytoget, which operates the distance to Oslo airport and the British railway operator Go-Ahead, which in 2018 won the tender to operate the distance Oslo-Stavanger. Rolling stock is typically owned by operators.

II LEGISLATIVE FRAMEWORK

In Norway, there are no specific laws governing the financing of aircraft, ships or rolling stock, and such financing will be governed by generally applicable legislation relating to financing, contracts, security rights and insolvency.

In relation to aircraft, Norway has ratified and incorporated into Norwegian law the Cape Town Convention on International Interests in Mobile Equipment (the Cape Town Convention) and the protocol thereto on matters specific to aircraft in 2011. The Convention and the protocol have been incorporated in Norwegian law pursuant to the Norwegian Act on International Security Rights in Movable Property.

Norwegian-based banks have for a long period been active in the shipping and offshore financing market, including as arrangers of syndicates. Norwegian law is a common choice of law within shipping and offshore financing both in bilateral and syndicated financing deals including Norwegian and foreign banks that are arranged or led by banks based in Norway. There are also examples of Norwegian law as the choice of law for aviation financing.

Domestic and international law and regulation

Ships

Norwegian ships and shipping activities are generally regulated by the Norwegian Maritime Code and international conventions. Norway's obligations pursuant to various conventions have been implemented in the Maritime Code and other applicable legislation, thereby securing that Norwegian rules relating to, *inter alia*, registration of legal ownership and encumbrances, arrest and forced sale are harmonised with international maritime law principles. Norway has implemented a tonnage tax system for shipping companies, and eligible companies within the tonnage tax regime are not subject to general income tax.

Registration of ships and security rights is offered through the Norwegian Ordinary Ship Registry (NOR) and the Norwegian International Ship Registry (NIS). NIS offers registration to vessels owned by foreign entities.

Norway has ratified a number of conventions, protocols and amendments regarding safety requirements, to solidify its position as one of the safest shipping nations in the world. Ships registered in either of the Norwegian ship registers are also subject to Norwegian and international recognised technical and nautical standards.

Aircraft

Aircraft registered in Norway are regulated by the Norwegian Aviation Code, including in respect of operation, safety and registration of security and the Norwegian Act on International

Security Rights in Movable Property, which incorporates the Cape Town Convention and the Aircraft Protocol thereto. As Norway is a member of the European Economic Area, Norwegian-registered aircraft are also subject to various EU regulations, and Norway has been a member of the European Aviation Safety Agency (EASA) since 2005. Further, Norway has ratified the 1948 Geneva Convention on Recognition of Rights in Aircraft and the 1933 Rome Convention on Precautionary Arrest of Aircraft. Both conventions are, however, subject to the provisions of the Cape Town Convention.

Aircraft with a Norwegian owner may be registered in the Norwegian Civil Aircraft Register, which means that the aircraft will be subject to the Norwegian Aviation Code. Security in an aircraft may either be registered in the Civil Aircraft Register or in the International Register created pursuant to the Cape Town Convention. It should be noted that the Cape Town Convention ranks ahead in any conflict with the national legislation. For smaller aircraft, the Cape Town Convention does not apply and rights over such aircraft may only be registered with the Civil Aircraft Register.

Rail

Railway operations are governed by the Norwegian Railway Act. The Act primarily contains regulatory provisions and is thus not relevant for the financing of rolling stock. Unlike ships and aircraft, there is no national register for rolling stock. However, individual registered pledges over rolling stock can be created, or the assets can be pledged as part of a floating charge over the railway company's machinery and plant, in both cases pursuant to the Norwegian Act on Pledges.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Norwegian financial institutions are generally regulated by the Norwegian Financial Businesses Act. The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV) have been implemented in Norwegian law through the Norwegian Financial Businesses Act and, *inter alia*, the Norwegian Regulation of Capital Requirements and Adaption of CRR/CRD IV, the Norwegian Regulation of Liquidity Management and the Norwegian Regulation of Calculation of Liquid Assets, Payments and Disbursements of the Liquidity Reserve.

ii Supervisory regime

Norwegian banks and other financial institutions are supervised by the Norwegian Financial Supervisory Authority.

Lending is a regulated activity in Norway. Banks and other financial institutions established in Norway and that conduct lending activities in Norway must operate under a Norwegian licence from the Norwegian Financial Supervisory Authority. Banks and other financial institutions conducting cross-border lending activities in Norway from other countries within the European Economic Community (EEC) must have a licence from the relevant EEC country that covers the relevant lending activity and that has been duly notified to the Norwegian Financial Supervisory Authority.

IV SECURITY AND ENFORCEMENT

i Security

Shipping

Under Norwegian law, mortgages over ships can be established and are perfected by registration in either NOR or NIS (as applicable). Such registration will give the mortgage protection from third parties, including the shipowning entity's creditors or bankruptcy estate. Mortgages can also be established in ships under construction. Ship mortgages also create charges over certain parts of the ship's equipment; for example, navigation or rescue equipment, spare parts and tools, whether the equipment is aboard or temporarily removed from the vessel. However, the mortgage does not create charges over bunkers or other consumables. Ship mortgages and other registered rights in the ship rank behind maritime liens according to the Norwegian Maritime Code, which is based on the provisions of the 1967 Brussels Convention on Maritime Liens and Mortgages. If the shipowning entity goes into bankruptcy proceedings, the bankruptcy estate has a mandatory lien in the ship for an amount equal to the lower of 5 per cent of the ship's value or 805,000 kroner.²

Apart from a registered mortgage, ship financing is in many cases secured by, *inter alia*, assignments of earnings and insurances, account pledges and, if the shipowning company is a special purpose vehicle, a share pledge.

It is not possible to validly create and perfect a security right in a charterparty contract (or any other contract as such) under Norwegian law. If the charterparty is governed by UK law, it is quite common practice in Norwegian ship financing to create an assignment of charter governed by UK law. It is, however, uncertain whether such a security right will be enforceable if enforcement is initiated before Norwegian courts, and to our knowledge this issue has never been subject to litigation in Norway.

Aircraft

Mortgages in a Norwegian registered aircraft may be registered in the Norwegian Civil Aircraft Register or in the International Register created pursuant to the Cape Town Convention. Mortgages registered in the Civil Aircraft Register will include certain movable parts such as engines and propellers, even if these are held in 'pools' and not attached to the mortgaged aircraft. A mortgage registered in the International Register in accordance with the Cape Town Convention is not believed to include such equipment. As with ships, registration of a mortgage is necessary to obtain legal protection against third parties, including creditors.

Generally, mortgages and other registered rights in aircraft rank behind salvage charges and costs to preserve the aircraft, which will give rise to mandatory liens and detention rights if the relevant claims are not covered, pursuant to the Norwegian Aviation Code. Further, the non-payment of fees incurred in using a Norwegian airport or fees for services in connection therewith, will give the airport owner the right to detain the aircraft or another aircraft owned or used by the same entity to secure payment. Such detention right is, however, subject to the same limitations as are applicable to the arrest of aircraft (i.e., aircraft that are operating a regular route open to the public, or an aircraft that is presently ready for take-off for the purpose of transporting persons or goods, cannot be detained).

² The amount is calculated as follows: $700 \times R$, and R (which is an abbreviation for 'court fee') is currently 1,150 kroner and subject to annual adjustments by the Norwegian authorities.

As a consequence of the dual system for registration of security rights in aircraft as described above, creditors have a tendency to charge aircraft both in accordance with national legislation and the Cape Town Convention.

Assignments of insurances and earnings, account pledges and other types of security, including a similar security package as described for ship financing, may be established to secure financing of aircraft.

Rail

Norway does not have a specific register for encumbrances over rolling stock. However, locomotives, carriages, etc., can be pledged individually and registered on the owner's sheet in the national register of movable property. This creates a pledge that closely resembles a regular mortgage, including in relation to protection from third parties.

ii Financing of contracts

Shipping

Shipbuilding contracts are usually financed through traditional secured credit facilities, typically in the range of 50–80 per cent of the purchase price of the new build. The payment of instalments to the yard during the building process will typically be secured by a refund or performance guarantees issued by the yard's bank or an export credit agency; for example, the Norwegian Export Credit Guarantee Agency. Another financing model of building contracts used is sellers' credits granted by the yards, usually secured by guarantees or other security.

Aircraft

In Norway, deliveries of new aircraft are traditionally financed through bank debt or financial leasing, including varieties of sale and leaseback schemes. However, airlines often meet their demand for new aircraft through operational leasing, reducing their need for capital and financing schemes.

Norwegian Air Shuttle has an expansive orderbook financed through a mix of export–import guaranteed funding, syndicated bank facilities, bond issues and sale and leaseback transactions.

Rail

As mentioned, state-owned NSB is the main operator and is largely self-financed. However, NSB issues bonds under its EMTN programme when needed, and has an available syndicated facility of 2 billion kroner.

iii Enforcement

Norwegian enforcement rules are based on the main principle that enforcement of security must be carried out through the courts, and contractual terms of the security to the effect that the mortgagee may enforce the security by way of self-help outside the courts will, as a rule, be deemed invalid.

However, the creditor may agree with the debtor to enforce security by way of self-help remedies following the debtor's default, and such arrangements will be upheld by the courts. Further, in relation to account pledges and share pledges, the parties are free to agree on any enforcement procedure, including self-help remedies, pursuant to the Norwegian Act on

Financial Collateral. In relation to assigned claims, self-help remedies are also available by operation of law, by way of taking possession or private sale, according to the Norwegian Enforcement Act.

For security in aeroplanes created and registered pursuant to the Cape Town Convention, the self-help remedies set out in the Convention are available to the creditor, without court proceedings or approval.

The most common way to initiate enforcement against a vessel is to apply to the local court for the arrest of the ship while it is in, or bound for, a Norwegian port. If the application is accepted, the vessel will be subject to an obligation to stay in the port. Arrest of ships is a fairly simple procedure to carry out under Norwegian law, and it can be arranged in a timely manner and without excessive costs.

Arrest of aircraft may also be carried out following the above-mentioned procedure. However, aircraft that are operating a regular route open to the public, or aircraft that are presently ready for take-off for the purpose of transporting persons or goods, will not be obliged to stay in the airport if arrest is approved.

In addition to the arrest rules set out in the 1952 Arrest Convention, which has been adopted by Norway, it is generally a requirement under Norwegian law that the creditor can demonstrate a probable cause for arrest. However, in practice, an important exception is made for mortgage claims in a vessel or an aircraft that are due, which are accepted as a basis for arrest without applying a test for probable cause. For aircraft, the above exception only applies if the mortgage is duly registered.

The holder of a registered mortgage over a vessel may request that the court initiates judicial sales proceedings, either by way of a court supervised private sale or an auction. Generally, both sales methods will free the vessel of all encumbrances and debts, except encumbrances with a better priority (if any) than that of the enforcing creditor.

As a starting point, only the ship from which the claim arises can be arrested under Norwegian law. However, Norway recognises the right to seek sister ship arrests in accordance with the Arrest Convention; that is, if two vessels are owned by the same legal entity being the debtor of the relevant claim, an arrest can be initiated against either of the vessels, in respect of a claim related to one of the ships. If each of the 'sister ships' are owned by single-purpose companies that are both owned by the same holding company, the arrest of one sister ship for claims against the other sister ship will not be available.

Arrest of vessels may be made for security only, and the creditor does not have to initiate substantive proceedings in Norway regarding the claim; for example, if proceedings have been initiated in a different jurisdiction.

iv Insolvency regulation in Norway

Bankruptcy and insolvency proceedings are regulated by the Norwegian Bankruptcy Act, which incorporates two formal procedures: debt settlement and bankruptcy proceedings.

However, after Norway's ratification of the Cape Town Convention, some aspects of the insolvency regulation have undergone changes. Among others, Norway adopted Alternative A of Article XI of the Convention's Aircraft Protocol. The provision is relevant in the event of the bankruptcy of airlines, and sets a maximum waiting period of 60 days, after which the bankruptcy estate is obliged to hand over aircraft and its equipment to the mortgagee.

V CURRENT DEVELOPMENTS

i Recent cases

There are no recent cases specifically related to financing of ships, aircrafts or rolling stock.

ii Developments in policy and legislation

In 2018 the Norwegian Financial Supervisory Authority drafted a consultation memorandum and a proposal for amendments in Norwegian legislation to implement the rest of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV). The proposed amendments to the legislation have not yet been passed.

On 7 December 2017, the group of governors and heads of supervision of the Basel Committee adopted a global standard for capital adequacy. The provisions that are laid down will most likely affect prospective capital adequacy in Norway as well, including, *inter alia*, a new standard for credit risk with an increased degree of risk sensitivity and a new output floor equivalent to 72.5 per cent of the calculation basis.

iii Trends and outlooks

Shipping

Norway maintains its position as one of the largest shipping nations in the world. The number of ships sailing under the Norwegian flag has increased, and the Norwegian International Register has gained considerable strength over the past year. The average age of the Norwegian fleet continues to drop, indicating strong fleet renewal, and the Norwegian fleet has also grown in deadweight tonnes over the past year.

Many Norwegian shipowners have a strong focus on developing sound environmentally friendly solutions as well as autonomous navigation solutions. Such initiatives are supported by governmental strategies, and shipowners believe this focus on technology will give them a competitive advantage in the international sphere.

The offshore supply segment has seen a sharp downturn since 2015. Revenues have decreased substantially, and many shipowners have a considerable part of their fleet laid up. Few are optimistic about a rapid recovery, and the consensus is that a new round of restructuring within this segment will be necessary. Consolidations have already taken place, and further consolidation is expected.

Aviation

The recent expansion of Oslo airport is expected to facilitate continued growth in capacity and activity in the Norwegian aviation industry. SAS has registered an increased part of its fleet in the Norwegian Civil Aviation Registry.

During 2018, one of the world's largest airline groups, International Airlines Group (IAG), submitted proposals to acquire the majority of the shares in Norwegian Air Shuttle. However, on 24 January 2019, IAG announced that it did not intend to make an offer. As of March 2019, Norwegian Air Shuttle is carrying out a fully underwritten rights issue of 3 billion kroner and has decided to sell a portion of its fleet, to strengthen its financial position.

Rail

In connection with new projects and developments, public–private partnerships have been considered, but have in the past failed to materialise.

However, a public–private partnership within railway passenger traffic was initiated for the first time in 2018, as the British railway operator Go-Ahead won the tender to operate the distance Oslo-Stavanger.

Other distances within goods and passenger traffic will in the near future be subject to competitive tendering, and will potentially have a material effect on the organisation and range of players in the market.

PORTUGAL

Maria João Dias and André Almeida Martins¹

I INTRODUCTION

i The transport finance industry

Shipping

Portugal is historically a country of maritime adventurers, shipowners and shipbuilders. Portugal's geography, which includes the archipelagos of Madeira and the Azores and a long Atlantic coast, calls for port activity and places Portugal as an entry point for the transport of goods into Europe.

Notwithstanding this, the shipping industry in Portugal has struggled in recent decades. The number of newly built ships was low and shipyard activity mainly focused on repairs and maintenance. In addition, a significant number of shipowners active in Portugal corresponded and still correspond to international carriers and not to nationally run companies.

In this context, Portugal took the opportunity to regain its importance as a player in the shipping sector through the International Shipping Register of Madeira (MAR). MAR is a second shipping register operating under the Portuguese flag, open to non-residents and allowing registration of both commercial vessels and yachts. MAR was created in the late 1980s within the International Business Centre of Madeira (IBCM), which consists of a set of incentives, mainly of a tax nature, approved by the European Commission and currently in its fourth version. MAR offers attractive conditions for shipowners and crew members, while ensuring high levels of security. MAR is proving to be very successful in attracting foreign investment and is now one of the largest shipping registers in Europe.² At the end of December 2018, MAR had 662 ships,³ which means that the register is growing year after year. Among those ships, a significant number – 96 vessels – belong to the main ship-owners acting at international level (APM-Maersk, Mediterranean Shipping Company (MSC), CMA CGM Group and Cosco Shipping).⁴

As a consequence of the above, and drawing on our experience, domestic financing for the construction and acquisition of vessels currently has a residual importance, while the relevance of Portugal as a flag-state significantly increased. In fact, in recent years there have

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2 Refer to Decree-Law 96/89, of 28 March (DL 96/89), which enacts the legal framework of MAR, and to the information available on the official IBCM website: www.ibc-madeira.com/en/welcome.html.

3 Information available at the official IBCM website: <https://www.ibc-madeira.com/pt/noticias/noticias/550-em-2018%20cinm-mantém-crescimento-de-entidades-licenciadas-e-de-emprego.html>.

4 IBCM official newsletter 2018-01.

been several significant financings for the construction or transfer of ships at an international level, connected with Portugal through MAR. The registration of vessels in MAR calls for the application of the Portuguese jurisdiction, mainly as concerns security packages.

More recently, the links to Portugal appear to be expanding. In fact, there has been a significant increase in new constructions in Portugal. The press reported several new constructions in the shipyard Estaleiros de Viana. This shift appears to mean that there is now room for financing new constructions in Portugal.

On the other hand, recent legislative changes focused on modernising the ordinary register in Portugal. Therefore, the Portuguese flag is aiming to also become relevant at the level of the ordinary register.

Aviation

The main Portuguese airports are located in Lisbon, Porto, Faro, Funchal (Madeira) and Ponta Delgada (the Azores). More than half of the movements and passengers go through Lisbon airport. In 2018, as in 2017, an overall increase of activity in the main airports was noted. The force behind this increase is international air passenger transport, in which low-cost airlines – among others, easyJet and Ryanair – are playing a significant role. According to the information available for the third quarter of 2018, the most important airlines at the main airports are in general TAP, Ryanair and easyJet. In Ponta Delgada, the presence of SATA Air Açores and SATA Internacional is also very significant, whereas in Funchal Transavia Airlines replaces Ryanair in the top three airlines and in Faro Jet2 also plays an important role.⁵

At the end of 2017, there were 1,227 aircraft registered in Portugal, which represents an overall increase of five aircraft in relation to 2016. The total number of aircraft includes, among others, 605 intended for private transportation, 230 for non-regular transportation and 85 for regular and non-regular transportation. There were also 28 companies licensed for air transportation and 16 for executive aviation.⁶ In our experience, numerous aircraft are operated in our jurisdiction under lease or financial lease agreements.

Rail

The railway network in Portugal is currently managed by Infraestruturas de Portugal, SA (IP), a public company that resulted from the merger of Rede Ferroviária Nacional – REFER, EPE (REFER) and EP – Estradas de Portugal, SA, enacted by means of Decree-Law 91/2015, of 29 May and which is responsible for managing road and rail infrastructures, under a concession agreement.

ii Recent changes

The main changes to the transport industry in Portugal over the past five years consist of political responses to the global financial crisis, implemented through legislative or regulatory measures.

In this context, the privatisations of both a national shipyard (Estaleiros de Viana) and the management body of the main Portuguese airports (ANA) took place. Transportes Aéreos Portugueses, SA (TAP), the national airline, has also been partially privatised.

5 Quarterly Statistics Report concerning 2017, available at <http://www.anac.pt/vPT/Generico/PublicacoesINAC/BoletinsEstatisticosTrimestrais/Paginas/BoletinsEstatisticosTrimestrais.aspx>.

6 https://www.anac.pt/SiteCollectionDocuments/Publicacoes/anuarios/ACC_2017.pdf.

In a different matter, in the judgment of the Court of Justice (First Chamber) of 11 September 2014 (Case C-277/13), Portugal was censured in connection with competition restrictions at Lisbon, Porto and Faro airports concerning ground-handling activity (baggage handling, ramp handling and freight and mail handling). In spite of this, Parliament Resolution No. 78/2016, approved on 31 March 2016, provides some guidelines that show that the liberalisation process of the ground handling services in Portugal may be put on hold.

Portugal has also been undergoing changes over the past few years aimed at enabling or providing incentives for transportation on electric power and on the increase of the renewable sources of energy.

Technology is also taking the spotlight in the transport sector. In 2017, certain measures in transport-related industries, such as the Single Port Invoice,⁷ came to light. In turn, legislation regarding the transport of passengers in ordinary vehicles by means of electronic platforms was enacted in 2018, by means of Law 45/2018, of 10 August.

In summary, some of the main changes to the transport industry in Portugal over the past years concern the increase of private investment in traditionally publicly held companies and the international pressure to allow competition, together with the increasing awareness of the relevance of technology and environmentally friendly sources of energy.

II LEGISLATIVE FRAMEWORK

The financing of aviation, rail and shipping assets is not subject to specific regulations in Portugal. In general terms, the common legislation applicable to civil and commercial matters applies.

Notwithstanding this, there are certain specificities particular to the financing of transport assets when security interests are created. Mortgages are the most common guarantee granted in Portugal to secure the financing of transport assets and may be subject to specific rules, depending on the financed asset and its registration rules.

Finally, the legal framework applicable to transport matters in Portugal is highly fragmented. There are numerous outdated provisions and conventions, which sometimes overlap with European Union instruments or conflict with common practices. Even though this general note does not apply to MAR's specific regime nor does it currently deter transport finance in Portugal, this factor should be taken into consideration by operators in the Portuguese transport sector.

i Domestic and international law and regulation

The ship register system in Portugal is a dual registration system, comprising an administrative register and a commercial register.

Up until recently, the cornerstones of the ordinary register's legal framework were the General Regulation of Captaincies and Regulation of Recreational Navigation, established by Decree-Law No. 124/2004, of 25 May, which regulated the administrative register, and the commercial register, enacted by Decree-Law No. 4264, of 14 November 1959. Recently, Decree-Law 92/2018, of 13 November (DL 92/2018) enacted a simplified register procedure,

⁷ The Single Port Invoice was enacted by Decree-Law 6/2017 of 6 January and Order 14/2017 of 10 January.

which revokes the register provisions of the General Regulation of Captaincies and Regulation of Recreational Navigation. Therefore, and among other measures, DL 92/2018 replaces the provisions concerning the administrative register.

Other relevant pieces of legislation apply. Pursuant to Article 589 of the Portuguese Commercial Code (the Commercial Code), mortgages over vessels may guarantee up to five years of interest, while the ordinary regime set out in Article 693 of the Portuguese Civil Code (the Civil Code) only allows for a maximum of three years.

DL 96/89 sets out some specific rules applicable to mortgages registered in MAR. In fact, and among other specificities, MAR's regime allows the parties to choose the law applicable to the mortgage. This option may be particularly interesting taking into consideration, for example, that a mortgage under Portuguese law may not allow for self-help remedies.

If the parties fail to choose the applicable law, Portuguese law will apply nevertheless. In that scenario, however, the right to release a mortgage set out by Article 721(b) of the Civil Code will not apply. Such a right would allow the acquirer of the mortgaged asset to cancel the mortgage by paying the mortgagee an amount equal to the price paid for the mortgaged asset. Pursuant to the MAR regime, release under those circumstances can only occur if the acquirer undertakes to pay the mortgagee for all rights under the mortgage agreement.

Recently, by means of Decree-Law 92/2018, of 13 November (DL 92/2018), the possibility of choosing the law applicable to the mortgage was also adopted in the ordinary register and the exception to Article 721(b) of the Civil Code were also set out, in similar terms, for the ordinary register.

Concerning aviation, the registration of aircraft in Portugal must be submitted to the ANAC, further to Decree 20062, of 13 July 1931 (the Air Navigation Regulation). ANAC is also competent to register mortgages.

Finally, it should be noted that Portugal did not sign the Cape Town Convention on International Interests in Mobile Equipment.

ii Specific practices

Under Portuguese law, rights *in rem* usually are constituted or transferred by means of the applicable agreement. However, mortgages require registration and will only be deemed incorporated upon registration, which should be carefully provided for within a financing.

The possibility of choosing the law applicable to the mortgage registered in MAR – and now also in the ordinary register – should be carefully evaluated, taking potential discrepancies between applicable jurisdiction and applicable law specifically into consideration, as well as accounting for any enforcement issues that could arise.

Finally, and given the fragmented legal framework applicable to the Portuguese transport industry, it is advisable to liaise beforehand with the competent authorities for the registration of the financed asset concerning any aspect of the transaction that may give rise to registry or regulatory issues.

In this regard, it should be noted that MAR is very approachable and usually renders timely and useful support for the clarification of any doubts arising in a specific transaction.

III FINANCIAL REGULATION

In Portugal, only credit institutions have permission to grant credit as a professional activity. The legal definition of a credit institution is provided by Decree-Law No. 298/92, of 31 December (DL 298/92). DL 298/92 enacts the General Credit Institution and Finance

Companies Regime, which regulates the activities of banks and other financial institutions. According to DL 298/92, credit institutions are defined as entities whose activity consists of receiving deposits from the public, or other kinds of repayable funds, and granting credit on their own account. Only entities expressly recognised as credit institutions are authorised to carry out financing activities. Obviously, banks, as the main credit institutions, assume a central role in the field of financing activities.

Portugal is part of the single supervisory mechanism, with the banking system supervised by the Bank of Portugal (BdP) in partnership with the European Central Bank (ECB). Created to ensure the safety and soundness of the European banking system, the single supervisory mechanism comprises the ECB and the competent national authorities of each Member State of the euro area (of which the BdP is part). The ECB directly supervises the main credit institutions, while the BdP is responsible for the supervision of the remaining institutions. Notwithstanding this, the ECB has the power to replace the BdP at any time and directly supervise the other institutions. In addition, whenever credit institutions or financial companies also pursue financial intermediation activities, they will be subject to the supervision of, and regulations issued by, the Portuguese Securities Exchange and Market Commission (CMVM). The same applies to the insurance intermediation activities that may be pursued by banks, which are also subject to the supervisory powers of the Portuguese Insurance and Pension Funds Supervisory Authority, being required in such case to comply with the regulations or circular letters issued by the latter.

i Regulatory capital and liquidity

The need to ensure the safety and soundness of the national (and European) banking system after the 2007 international financial crisis, and the adoption of the Basel III Agreements – which were implemented in the European Union through Directive No. 2013/36/EU and Regulation No. 575/2013 – resulted in the implementation of a set of important measures intended to ensure the solvency and liquidity of banks and to reinforce the powers of the supervisory authorities.

Consequently, among other aspects, Portuguese banks are now obliged to ensure that their own funds are never below the minimum amount of share capital legally required. Additionally, current Portuguese legislation compels banks to have a minimum share capital of €17.5 million for banks and €5 million for investment firms in general.

Under Regulation No. 575/2013 on prudential requirements for credit institutions and investment firms, institutions must maintain a common equity Tier 1 (CET1) capital of at least 4.5 per cent of their risk-weighted assets (RWAs), a Tier 1 capital of at least 6 per cent of their RWAs and a total capital of at least 8 per cent of their RWAs. Nevertheless, and as agreed with the ECB, the European Commission and the International Monetary Fund in the context of the bail-out package provided to Portugal in 2011, the BdP determined that Portuguese credit institutions and investment firms must have a CET1 ratio not below 7 per cent. This obligation is to last until the adoption in full by these entities of the rules applicable under the Capital Requirement Directives IV package.

ii Supervisory regime

The supervisory system for Portuguese banks is based on two fundamental components: prudential supervision and 'supervision of conduct'.

Prudential supervision has the main objective of ensuring credit institutions' financial stability and the security of the funds that are entrusted to them. Therefore, supervisory

institutions have power to authorise the incorporation of credit institutions, monitor their activity, enforce compliance with the applicable regulations, issue rules and recommendations, sanction potential infractions and take extraordinary measures to correct irregularities.

On the other hand, supervision of conduct compels credit institutions to respect certain standards of conduct in their relations with clients. This second component of this supervisory regime entitles supervisory institutions to establish rules to assure the transparency of the information provided by credit institutions to their clients, as well as the fairness of products and financial services transactions – either between credit institutions or between credit institutions and their clients – in addition to regulatory and supervisory powers. The legal framework also grants clients the right to file complaints with the BdP.

2017 was marked by the entry into force of two new laws, namely Law No. 83/2017 of 18 August and Law No. 89/2017 of 21 August, which provide for preventive and repressive measures to fight money laundering and terrorism financing, and partially transpose the Directive No. 2015/849/EU from the European Parliament and Council of 20 May 2015 into Portuguese law. In particular, Law 89/2017 establishes the legal regime of the Central Registry of the Effective Beneficiary (CREB), which is further regulated and detailed by Ordinance No. 233/2018, of 21 August. The CREB consists of a database with information regarding the effective beneficiary of entities subject to it (e.g., commercial companies), managed by the National Registry Office. All entities subject to the CREB have the duty to provide sufficient, exact and up-to-date information on its effective beneficiaries, all circumstances that indict such quality and the information on the economic interest they hold in the entities.

Finally, it is important to stress the existence of a central credit register. The central credit register is a central database, managed by the BdP, that contains detailed information regarding the loans granted by credit institutions to their clients.⁸ All credit institutions are obliged to communicate this information so that the BdP, on a monthly basis, may determine the amount of credit granted to each client. Through this mechanism, credit institutions are able to evaluate the risks of granting credit to a specific client with a higher degree of accuracy.

IV SECURITY AND ENFORCEMENT

In the Portuguese context, financing of new assets usually follows the traditional pattern of credit against a security interest over the asset. Accordingly, security plays a key role in both the negotiation and the execution of the asset financing agreement. The most common security required by finance providers is, unquestionably, a mortgage over the asset, but the security package may also include other instruments such as pledge over shares of ship-owning companies, pledge over bank accounts, assignment of earnings or receivables and retention title instruments. Currently, Portugal is not a party to any convention regarding securities over aviation, rail and shipping assets (such as the Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, adopted in Brussels on 10 April 1926, and the Convention relating to Maritime Liens and Mortgages, adopted in Geneva on 6 May 1993).

⁸ Only balances for liabilities with a value of at least €50 need to be communicated.

i Security

Shipping

Portuguese law provides a specific and mandatory framework on security interests over vessels that, among other aspects: (1) sets out a list of 15 credits that enjoy a priority-ranking privilege (Article 578 of the Commercial Code); and (2) establishes that the vessel's constructor and the maritime rescuer are granted the right to retain the vessel as security for the payment of the credits arising from its construction and the maritime salvage (Article 25 of Decree-Law 201/98, of 10 July (DL 201/98) and Article 14 of Decree-Law 203/98, of 10 July). This mandatory framework prevails over any provisions set forth in the asset financing agreement and its respective security package.

According to that special framework, namely the provisions of the Commercial Code, there is a special regime for mortgages over vessels that differs from the mortgage's general framework set out in the Civil Code. In fact, the mortgagee is granted a priority-ranking privilege, which prevails (even in the event of the mortgagor's insolvency) over: (1) the priority-ranking privileges provided for by the Civil Code and any other statutes (Article 574 of the Commercial Code); and (2) rights of retention subsequently constituted (Article 750 of the Civil Code). In this regard, the recent Decree-Law 92/2018, of 13 November (DL 92/2018) introduced some reforms to the regime for mortgages over vessels.⁹ On the one hand, parties are now allowed to designate the law applicable to the mortgage, which must be indicated at the time of registration, together with the handing over of a copy of the relevant legislation. On the other hand, Article 21, No. 6 sets forth that the purchaser of mortgaged assets can only exercise the right to extinguish the mortgage (provided for in article 721 of the Civil Code) if the exercise of this right guarantees the mortgagee full payment of all the rights and charges arising from the mortgage agreement.¹⁰ Notwithstanding this, still pursuant to the above-mentioned special regime, court expenses and monetary consideration for maritime salvage are ranked as having priority over the mortgagee's credit (Article 578(1) (2) of the Commercial Code).

Aviation and rail

Portuguese law does not grant specific priority-ranking privileges to entities that finance the acquisition of aviation or rail assets. As such, the lender's position – if a security interest is constituted over the aircraft or the rolling stock – results from the general framework set out in the Civil Code.

In fact, Portuguese law only provides the Portuguese state, the autonomous region of the Azores and the airports' managing body with a priority-ranking privilege over the aircraft as security for the payment of: (1) fees due for the operation of airline companies in Portuguese airports; and (2) administrative fines imposed for infringement of the framework governing non-scheduled transport services (Article 46 of Decree-Law 254/2012 of 28 November, Article 30 of Regional Legislative Decree 35/2002/A of 21 November and Article 38 of Decree-Law 19/82 of 28 January).

9 In some aspects, introducing provisions already in force in the International Ship Registry of Madeira.

10 Therefore, rendering non applicable to these mortgages the provision of article 721b of the Civil Code according to which the acquirer of a mortgaged asset may extinguish the mortgage by declaring he or she is ready to pay creditors up to the amount for which he or she acquired the goods (or its estimated value when the acquisition was free of charge or with no price fixing).

According to general rules, the mortgagee's credits shall be ranked as having priority over: (1) the credits secured by a priority-ranking privilege that has been subsequently constituted; and (2) the credits held by entities that enjoy a right to retain the aircraft (Articles 686, 750 and 758 of the Civil Code).

In practice, aircraft are usually acquired under a financial lease agreement. Generally, the parties enter into a sale and leaseback arrangement: the airline operator negotiates the construction and acquisition of the asset, purchases it and oversees the import procedure; then, registers the aircraft and sells it to the financial lessor. Subsequently, the operator is granted the use of the asset under a financial lease agreement (the term of which may not exceed 30 years). In many cases, the financing is granted by several financial lessors (acting as a consortium), as a means to mitigate the economic risk of the transaction.¹¹

ii Enforcement

A secured creditor may enforce security by means of judicial action filed against the debtor, which may encompass an interim measure (namely, an arrest), a main declaratory action and, finally, an enforcement procedure in which the asset is sold through the court. The merits of the dispute may be decided in accordance with the laws of another jurisdiction if private international law leads to the exclusion of Portuguese law (e.g., in the event that the parties have validly chosen the law of another jurisdiction to govern the financing or the security relationship).

It is generally stated that, after the breach of the contract, the mortgagee may take possession over the secured asset without filing a claim if the parties have entered into an agreement whereby the mortgagee undertakes: (1) to request an updated valuation of the asset (in accordance with a procedure defined by the parties); and (2) to repay the amount corresponding to the difference between the asset's value and the amount of the debt. In fact, it is said that the rules prohibiting self-enforcement only apply if the procedure is not agreed with the mortgagor and may not be controlled by this entity (otherwise, their rights are not jeopardised).

iii Arrest and judicial sale

Shipping

Portugal has ratified the Convention for the Unification of Certain Rules relating to the Arrest of Sea-going Ships, adopted in Brussels on 10 May 1952 (the Brussels Convention). The arrest of a vessel is governed by Brussels Convention whenever: (1) the claimant holds a maritime claim pursuant to Article 1 of the Brussels Convention (namely a credit secured by a mortgage); and (2) the vessel is present in Portugal and flying the flag of a contracting state.¹² The nationality or the address of the owner of the vessel or its domicile is thus irrelevant.

The Brussels Convention can only be applied when at least one of two elements (the flag of the vessel or the domicile of the applicant for the arrest) does not have a connection with the Portuguese jurisdiction (Article 8(4)).

11 See Conceição Soares Fatela, 'A Locação Financeira de Aeronaves', *Cadernos de Direito Privado*, No. 49, January/March 2015.

12 The protective order may also be accepted if the vessel flies the flag of a non-contracting state: in this case, the vessel may be arrested to secure a maritime claim pursuant to Article 1 of the Brussels Convention, or any other claim that legitimates the arrest according to the *lex fori* (Article 8(2)(3) of the Brussels Convention).

The Brussels Convention regulates: (1) the arrest of the ship to which the credit refers (offending ship), when the debtor is the owner or the charterer or whenever a third party is a debtor of a maritime credit related to that ship; and (2) the arrest of another ship (sister ship) belonging to the person who, on the date of the constitution of the credit, is the owner or the charterer of the ship to which the credit refers, or debtor of a maritime credit, unless the injunction seeks coercive compliance regarding the credits indicated in Article 1(1)(o)(p) or (q) of the Brussels Convention.

For a vessel to be arrested under this international instrument, a mere claim of the right of maritime credit suffices; it is not necessary for the claimant to present evidence for the procedure, nor to allege and prove the risk of the loss of the guarantee represented by the asset (*periculum in mora*) (Articles 3 and 5 of the Brussels Convention).

If the case does not fall within the scope of the Brussels Convention, the Portuguese Civil Procedure Code (CPC) will be applicable. In this circumstance:

- a* the claimant must allege and present evidence of the relevant facts, including the credit entitlement and the grounds for granting the interim measure (*fumus boni iuris*), the risk of losing the security and the admissibility of attaching the vessel (Articles 365(1), 368(1), 391(1), 392(1) and 394 of the CPC);
- b* if the legal requirements are met, the arrest is declared by the court without hearing the defendant (Article 393(1) of the CPC); and
- c* the vessel may be arrested even if it is undertaking a journey (Article 9(1) of DL 201/98).

The Brussels Convention and the CPC set out similar provisions:

- a* the claimant may request the arrest even if it does not enjoy any security interest (mortgage) over the vessel;
- b* other ships owned by the debtor may be arrested, even if they have not been given as security; and
- c* the claimant may be liable for all damages arising out of the arrest in the event that the measure is deemed unjustified (this liability shall be governed by the Portuguese internal rules).

If the arrest is granted, the asset is judicially seized and physically apprehended. Notwithstanding, the mortgagee may request the court that the vessel continues to operate until its judicial sale, if the mortgagor expressly agrees or, if said agreement is obtained, by providing an adequate guarantee (Articles 769 and 770 of the CPC).

Following the arrest decision, the claimant must file a main declaratory action within 30 days to obtain an enforceable decision regarding its credit and the respective security.

After obtaining a favourable ruling in the main proceedings, the claimant has to file an enforcement proceeding to judicially sell the vessel. The judicial sale is carried out by an enforcement agent, in accordance with the rules set out in the CPC that sets forth several sale methods (sealed bids, public auction, private negotiation). The vessel is sold free from any charges or encumbrances and normally 'as is'.

If the debtor is insolvent, the sale of the asset is governed by the Insolvency Code, as any other asset seized for the insolvency estate.

Aviation

In case the aircraft was acquired under a financial lease agreement, Article 21 of Decree-Law 149/95, of 24 June, entitles the financial lessor to make a request to the court for the

immediate apprehension and restitution of the leased asset in the event of termination of the financial lease agreement (due, among other grounds, to an event of default attributable to the financial lessee).

The granting of the interim measure depends on:

- a* the termination of the agreement having been declared by the financial lessor, by serving a written notice to the counterparty;
- b* the registration of the agreement having been cancelled; and
- c* the court considering proved – *prima facie* – the defaulting event, the non-delivery of the asset and the termination of the agreement.

Once the apprehension is ordered, the financial lessor is entitled to grant a third party the use of the asset, namely by entering into a sale and purchase, lease or financial lease agreement.

If the aircraft is owned by the airline company, judicial action (declaratory action or enforcement procedure) has to be filed to collect the debt (through judicial sale).

V CURRENT DEVELOPMENTS

i Developments in policy and legislation

One of the most important developments in transport finance over the past several years was enacted by Decree-Law 8/2009, of 7 January, which amended the Commercial Code to include the credits guaranteed by mortgages or pledges over the vessel in the third position of the ranking of privileges over the vessel.

This measure was followed, in 2011, by Portugal's withdrawal from the Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, adopted in Brussels on 10 April 1926.

In fact, up until those legislative measures were introduced, mortgages would be ranked in a less favourable way (from the credit institutions' perspective), which was presumably preventing registrations in Portugal (and in MAR). These changes were a turning point for creditors, which to some extent contributed to the growth of MAR.

Very recently, Decree-Law 43/2018, of 18 June, created a National System for Vessels and Maritimes, which aims at centralising and publicising all registrations and certifications concerning maritime activity. Shortly after, DL 92/2018 enacted a simplified register of vessels and crafts.

DL 92/2018 is currently a fundamental piece of the legislative framework in the ordinary register. DL 92/2018 addresses a variety of register matters, such as bareboat charter in, the formalities of bills of sale or specificities of the mortgages.¹³ The provisions of DL 92/2018 on the register of vessels entered into force on 1 January 2019.

On a different matter, DL 92/2018 put into place a special tax regime where the tax base is based on the tonnage of the ships and crafts (tonnage tax).

ii Trends and outlook for the future

Portugal is regaining its importance in the shipping sector, and specifically in the asset finance industry through MAR. In fact, the second registry in Portugal has undergone a steady and sustainable increase over the past years and is drawing the attention of shipowners

13 Please refer to Sections II.i and IV.i.

and finance parties alike. At the end of 2018, MAR had 662 ships. In 2017, MAR had 562 vessels¹⁴ and in 2016¹⁵ MAR had 491 vessels (40 commercial yachts, 73 recreational craft and 378 commercial vessels), with a gross tonnage of 12,076,294. At the end of the previous year of 2015, a total of 399 vessels were registered, with a gross tonnage of 7,925,042. The average age of the ships dropped from 11.9 years in 2015 to 11.8 in 2016, and currently it is 11.7 years.¹⁶ In our experience, lenders from jurisdictions as varied as Spain, China and Japan are relying on Madeiran mortgages to secure financing.

MAR is not only impressive in numbers. Its safety and quality standards maintain sound recognition worldwide. As a consequence, vessels flying the Portuguese flag were included, for the first time in 2017, in the index Qualship 21 of the United States Coast Guard. Likewise, Portugal maintained its position in the White List of the Paris MoU on Port State Control, which will be valid until June 2019.

The growth of MAR has been drawing public attention to maritime issues, particularly regarding the concerns of creditors in the financing of vessels and tax issues from the exploitation of the same. As a consequence, the ordinary register is seeking to mimic MAR. On the other hand, there are ongoing – and much needed – modernisation efforts in areas adjacent to the shipping register.

A broad, planned reform of the legal framework applicable to the maritime and transport sector in Portugal is long overdue. The legislative measures that came to light in 2019 are aligned towards the correct goals but, to some extent, lack in coherence. Notwithstanding this, the current refocusing of legislative efforts in the shipping sector is very exciting. We can anticipate that this once forgotten sector will increasingly be more dynamic.

14 With reference to the end of October 2017 and based on information made available on the official website of the International Business Centre of Madeira (IBCM): <https://www.abc-madeira.com/pt/noticias/noticias/511-mar-contribui-para-entrada-do-pavilhao-portugues-no-qualship-21.html>.

15 Official newsletter 2017-01 of CINM, encompassing data concerning 2016.

16 Information made available on the official website of IBCM: <https://www.abc-madeira.com/pt/noticias/noticias/550-em-2018%20cinm-mantem-crescimento-de-entidades-licenciadas-e-de-emprego.html>.

RUSSIA

*Alexander Mednikov*¹

I INTRODUCTION

i The transport finance industry

The financial sector is an important part of Russia's economy and includes national and international players (through Russian subsidiaries). The biggest banks, such as Sberbank and VTB, have the Russian state as their principal shareholder, but there are also a substantial number of purely privately owned institutions, such as Alfa-Bank, Otkrytiye and others. In addition to the banks, other types of institutions, including finance leasing companies and financial companies, are entitled to lend money under various arrangements. Following the Ukrainian crisis, substantive Western sanctions have been applied against the Russian financial sector, and a number of institutions have been directly affected.

As far as the transport finance industry in particular is concerned, a number of principal points should be noted. First, the current federal legislation allows almost unrestricted access to the international financial market for Russian lenders – in other words, any Russian commercial enterprise is permitted to borrow abroad in foreign currency. Second (and particularly important for shipping and aviation asset financing, and less so for rail assets), in many cases, lenders prefer to have the financed assets registered outside of Russia, because of the belief that this provides them with a more transparent and flexible means of enforcement of security measures. Indeed, in the 1990s, when the market reforms had just begun, Russian legislation did not provide the borrowers with sufficient protection in this respect; however, things have changed quite substantially since then. Third, the current terms of financing offered by Russian lenders are, in many cases, less attractive than those that are available on the international markets. Because of this, Russian borrowers acquire from foreign lenders in a large number of transport finance transactions. This is particularly true for the ship finance sector, but less so for aviation and rail asset financing, where Russian lenders have a bigger share of the market.

ii Recent changes

Over the past few years, Russia's legislation regulating many aspects of asset financing, in particular legislation on pledge and mortgage, has been considerably modernised in many respects. This is not directly connected with the Ukrainian crisis, but rather with the Russian government's goal of increasing Moscow's attractiveness as a financial centre of international

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importance. In particular, it is now possible to enforce a Russian law mortgage without a corresponding court judgment, as well as enter into mortgage management agreements between mortgagees, pledge rights over a bank account, etc.

II LEGISLATIVE FRAMEWORK

The list of legislative acts that apply to transport finance is quite substantial and includes the Civil Code of Russia, the Merchant Shipping Code, the Air Code, and Federal laws ‘on banks and banking activities’, ‘on hypothecation (mortgage)’, ‘on financial lease’ and ‘on registration of rights to aircraft and transactions with them’. Various aspects of (or relating to) financial transactions are also regulated by sub-legislative acts issued by various federal bodies of the executive branch (e.g., the government and the Ministry of Transport) and by the financial regulator (the Central Bank).

i Domestic and international law and regulation

In accordance with the Constitution of Russia, generally accepted principles and provisions of international law and international agreements to which Russia is a party form an integral part of Russia’s legal system. If there is conflict between provisions of national legislation and of an international agreement to which Russia is a party, provisions of the latter shall have priority. At the same time, the Civil Code of Russia recognises the right of the parties to choose law applicable to their contracts. Only in relatively few cases does the law explicitly state that certain contracts shall be governed by the Russian law – usually when the contract or its object is closely related to Russia. In cases when Russian law is not mandatorily applicable and the parties have chosen to apply foreign law, but the contract is closely related to Russia and not to any other country, applicability of foreign law chosen by the parties will be recognised by Russian courts, unless this would come into the conflict with imperative provisions of Russian law. In such cases, such imperative provisions will apply in spite of the choice of foreign law.

ii Specific practices

In most transport financing transactions, the parties will be relatively free to choose the law applicable to their contractual relations – this applies to the principal contract and to the associated contracts and instruments, in particular to the security instruments. In the majority of cases, choice of law will be determined by the lender: if the lender is a Russian institution, it will be most likely to insist on Russian law to govern the relations in question; if the lender is a foreign or international institution, the applicable law will most probably be the law of domicile of the lender or the law of the third country, which is ‘neutral’ to both parties, most often English law.

However, in most instances of transactions where the principal loan or credit agreement is governed by foreign law, provisions of Russian law will inevitably come into play in more than one instance. Most obviously, this will be the case when collateral is located in or registered in Russia. It should be noted that ships and aircraft are treated by Russian law as immovable property, and Russian law shall apply to the contracts in respect of immovable property that is registered in Russia. Russian law will also regulate the procedure of enforcement of the mortgage or other measures against collateral that is physically located on the Russian territory at the time of enforcement, even if it is registered abroad. It is also

necessary for foreign lenders to understand the impact of provisions of Russian law on such issues as insolvency, currency control, taxation of interest, enforcement of claims, customs issues, compliance requirements relating to the relevant transport operations, etc.

III FINANCIAL REGULATION

As outlined above, Russian financial legislation is fairly liberal with regard to providing Russian borrowers with access to foreign or international financial markets. Therefore, Russian financial regulations apply to Russian lenders (including the subsidiary banks of foreign financial institutions) irrespective of the nationality of the borrowers, but when foreign lenders provide loans to Russian borrowers, provided they do so directly (i.e., cross-border loans), they are subject to their national financial regulations.

i Regulatory capital and liquidity

As a member of the Basel Committee on Banking Supervision, Russia undertook to implement Basel III standards in accordance with the schedule adopted by the Committee; in other words, until 2018 inclusive.

ii Supervisory regime

In Russia, banking activities are subject to licensing, with licences being granted by the Central Bank of Russia. Banking institutions licensed in Russia are subject to supervision and control from the Central Bank of Russia, which in the recent past has also taken over supervisory functions in respect of other financial institutions – particularly exchanges and entities involved in the securities market.

IV SECURITY AND ENFORCEMENT

i Financing of contracts

There are two widespread mechanisms of financing new-build means of transport in Russia: through bank loans or through finance leasing.

In the first case, upon reaching the agreement and signing the appropriate instruments, the bank advances the amount of the loan either to the borrower directly or to the seller or builder of the respective means of transport as payment of the purchase price. Normally, the bank would fund only part of the purchase price with the remainder, on average 20–40 per cent, being pre-financed by the borrower itself. In most cases, the repayment of the loan and interest is secured by the mortgage or pledge of the respective means of transport, with loss and damage insurance placed in favour of the lender (jointly with the borrower), and with special arrangements in respect of the cash flow attributed to the item, channelled through a special account in the lender bank. In most cases, mortgage of the means of transport must be registered in the same registry where the title thereto is already registered; for ships, it is also possible to register them (and mortgages over them) in the registry of vessels under construction. The borrower becomes the owner of the respective item and starts to repay the loan.

In the second case, it is normally the finance leasing company or its SPV that becomes the owner of the ship, aircraft or rolling stock. Its purchase price is paid over time by the lessor (normally the item's long-term lessee or operator). When the lease payments are completed, the title to the item of lease passes to the lessee.

ii Enforcement

Russian legislation with regard to pledge enforcement has undergone substantial change over the past few years. Principal new trends have been the increase of protection of mortgagees' rights and simplification of enforcement. Initially, enforcement of mortgages was only possible on the basis of a court judgment. However, it has recently become possible to enforce a mortgage out of court – by public sale, by private sale or by appropriation of the object of mortgage by the lender. In accordance with the current regulations, in order for the pledge or mortgage to be enforceable without applying to the court, the respective pledge or mortgage contract must be executed in notarial form (certified by the notary public at the signing) and enforcement may in such cases be effected on the basis of the notary's enforcement. The legislation is yet to be tested by practice, but the availability of this option shows substantial progress.

Rights of the mortgagees are highly ranked: for example, in bankruptcy, the registered mortgagee, although obliged to surrender mortgaged property to the receivers, is also entitled to receive up to 70 per cent of the proceeds of the sale (80 per cent if the creditor is a bank that lent money for the purchase or construction of the respective property). Claims from the side of the mortgagees of the ship are outweighed only by the claims secured by the maritime liens, by the shipbuilder's lien and claims for costs of wreck removal.

iii Arrest and judicial sale

Russia is a party to the 1952 International Convention Relating to the Arrest of Sea-Going Ships and to the 2001 Cape Town Convention on International Interests in Mobile Equipment. Specific provisions concerning ship arrest on the basis of maritime claims are also contained in the Merchant Shipping Code of Russia (with the wording of respective provisions being based on the 1999 International Convention on the Arrest of Ships rather than the 1952 International Convention for the Unification of Certain Rules Relating to the Arrest of Seagoing Ships). Arrest of a ship or aircraft (or of any other property of the debtor or defendant) can also be applied for as a security measure or as a preliminary security measure within the frames of judicial procedure. In such case it will be governed by the Code of Civil Procedure and Code of Arbitration Procedure (the latter regulates procedures in Russia's commercial courts, which are traditionally known as 'arbitration courts').

The primary purpose and focus of arrest on the basis of a maritime claim is to obtain security – sale *pendente lite* is not possible under Russian law. Ship arrest may be imposed by the ruling of a competent court or, in some cases of arbitration, on the basis of an application of a creditor. The court must consider such application within the next day, and if the arrest is granted the vessel will be forbidden to leave port or its other location by the bailiffs or the harbour master. The applicant should be prepared to provide guarantee against damages caused by wrongful arrest on its own initiative or upon the order of the court. The vessel may be released from arrest only if the owner or debtor provides a guarantee in a suitable format. Normally, the vessel may be arrested if it is owned or bareboat-chartered by the debtor under a maritime claim. A sister ship (a vessel owned by the debtor but not connected with the

claim) may also be arrested. However, the 1952 Convention also provides for the possibility to arrest the vessel when the party responsible under the claim was merely the time-charterer of the ship.

OW Bunker

The recent collapse of OW Bunker, a major ship fuel supplier, raised a wave of claims and threats to arrest ships from the unpaid physical suppliers of fuel against the shipowners in many countries, including Russia. In some instances, shipowners that took delivery of the fuel have been time-charterers rather than owners or bareboat-charterers of the vessels in question, so the possibility of invoking the relevant provisions of the 1952 Convention was widely considered.

Procedure for judicial sales of ships or aircraft

Ships or aircraft may be sold on the basis of the court judgment ordering such sale or, as it was mentioned above, on the basis of the notary's endorsement, provided that originally the relevant mortgage or pledge contract was certified by the notary public. On the basis of the judgment, the court will issue an execution order, pursuant to which the bailiffs shall impose an executorial arrest and appoint a specialised organisation to make the arrangements for the sale. Notification of the sale shall be published and the court will also send notices of the intended sale to the registered owners and mortgagees. As a rule, the sale will be effected by way of public auction. If the sale is not successful, the creditor that initiated the sale may be entitled to take the title to the vessel, in which case 10 per cent will be deducted from the initial sale price of the vessel (25 per cent if sales repeatedly fail) and this will be set-off against claims to the owner. Proceeds of the sale shall first be used to cover the costs of the sale and related procedures, then the interest accrued and then the principal amount of the debt.

All procedural issues related to enforcement shall be governed by Russian law.

V CURRENT DEVELOPMENTS

Developments in policy and legislation

Russian civil legislation, particularly legislation on mortgage and pledge, as well as on loans and credit, is expected to develop further, which could lead to Russia becoming a more attractive jurisdiction for lenders. Russia's banking regulations are intended to gradually simplify foreign investors' access to the country's financial sector. However, the sanctions imposed against Russia in connection with the crisis in Ukraine are unlikely to be removed very soon, and this obviously has a negative impact on the economy's growth.

SPAIN

*Tomás Fernández-Quirós and Carlos López-Quiroga*¹

I INTRODUCTION

i The transport finance industry

It is important to consider that the climate for transport asset financing in Spain does not significantly diverge from that of general financing. Spain has experienced a recovery, showing an increased appetite from investors, increased competition, debtors seeking to refinance, the return of corporate financing and a need to offer more tailor-made solutions to each borrower. In fact, more equity solutions are now present in the sector.

In this context, market-standard clauses in loan transactions are being revisited, such as those on mandatory prepayments, undertakings, ratios, majorities and waivers, assignment, those that review the role of agency, intercreditor agreements, etc. Also of note is the increasing regulatory pressure (Basel III, etc.) and the concentration of the domestic financial sector (including the restructuring of the savings banks).

Shipping

Spain's ship finance industry is largely driven by shipbuilding, a sector that has been considerably affected by the global credit crunch, resulting in fewer and more complex transactions. We have seen Spanish banks financing (traditionally foreign) shipowners building in Spanish yards, and increasingly resorting to export credit tools.

Spanish banks' traditional approach to ship finance is based on a combination of project and corporate finance. Lenders typically seek out a stable long-term charter to back the financing, but invariably scrutinise the shipowner's balance sheet.

Another angle has been the granting of pre-delivery financing to Spanish yards to assist them in completing the construction of vessels, or in the issuance of refund guarantees.

In view of this scenario, we cannot disregard the fact that the Spanish ship finance market is (and has been) shaped by the Spanish tax lease framework. The EU challenge negatively impacted domestic ship finance between 2011 and early 2015. The recuperation of the Spanish economy and approval of a new tax lease framework at both domestic and EU levels have revitalised the market.

¹ Tomás Fernández-Quirós and Carlos López-Quiroga are partners at Uría Menéndez. The authors thank their colleagues Isabel Aguilar, Luz Martínez de Azcoitia, Sofía Rodríguez, José Sánchez-Fayos, Nicolás Nägele and Oscar Martín, who also contributed to the production of this chapter.

Aviation

According to recent official statistics from Aena, SA (the Spanish airports manager), 263.75 million passengers travelled through Spanish airports in 2018. In addition, long-haul routes are currently growing more quickly in terms of passenger numbers and seats offered.

Turning to financing tools, as in the international market, the domestic market is driven by financial tax structures, particularly operating leases. The entry into force of the 'Cape Town system' in Spain has created a new framework for secured financings within the aviation market.

Rail

Spain is undertaking a comprehensive modernisation of the railway system, including the construction of a new high-speed network. Having been frozen during the worst years of the crisis, it seems that infrastructure works have now been reactivated. The new regulatory framework and attempts to liberalise the passenger transport sector have bolstered the train finance market since 2013. Although the passenger market continues to be largely controlled by Renfe Operadora, several operators have attempted to enter the market. Although international passenger transport was opened to the market in 2010, national transport is still under Renfe's monopoly.

Significantly for the finance market, Renfe was divided into four companies, one being Renfe Alquiler de Material Ferroviario, in an attempt to emulate the United Kingdom's rolling stock operating companies (ROSCOs).

The trend by Spanish manufacturers has been to export rolling stock abroad with export finance support. However, this could change in the near future as it is expected that Renfe and other private transport operators will invest heavily to modernise their fleets before the passenger market is liberalised.

ii Recent changes

Shipping

Spain's ship finance industry will unquestionably benefit from the approval of the new tax lease framework based on the European Commission's decision of 20 November 2012, and from Royal Decree 874/2017 regulating interest-rate subsidies for credits for vessel constructions.

Aviation

Two significant recent events are notable in the aviation sector – the partial privatisation of Aena, SA in which the Spanish government still holds its majority stake and the approval of Royal Decree 1036/2017 regulating the civil use of remotely piloted aircrafts (RPAs).

Rail

The Spanish Rail Sector Act 38/2015 has been modified by Royal Decree-Law 23/2018 of 21 December, which transposed Directive (EU) 2016/2370 into the Spanish legal system. Royal Decree-Law 23/2018 opens up the public railway transport sector to competition as of 1 January 2019, so that any railway company can request capacity for the working timetable starting on 14 December 2020.

The Royal Decree-Law also modifies the price-regime for basic services, 'supplementary services' and 'ancillary services'.

According to the new wording of article 101 of the Rail Sector Act, prices for basic services cannot exceed the cost of providing the service plus a reasonable profit. Supplementary services and ancillary services are subject to prices agreed between private parties. However, when those services are provided by a sole operator, the prices cannot exceed the cost of providing the service plus a reasonable profit.

The former Sixteenth Additional Provision of the Rail Sector Act required Renfe Alquiler de Material Ferroviario, SA and Renfe Fabricación y Mantenimiento, SA to provide railway companies with access to railway equipment and maintenance services on a transparent, objective and non-discriminatory basis. Following the CNMC's recommendations in response to the draft bill for Royal Decree-Law 23/2018, this obligation has been kept in place and provisions have been introduced that govern the conditions on which both companies will provide services to operators that do not belong to the Renfe group.

II LEGISLATIVE FRAMEWORK

Domestic and international law and regulation

There are several notable provisions to take into account when financing the construction or acquisition of transport equipment. First, in the absence of an agreement or a specific act, the manufacture of transport equipment is regulated by the Spanish Civil Code, while the acquisition of transport equipment is regulated by the Commercial Code and, subsidiarily, by Spain's Civil Code.

Apart from this general rule, the following provisions specifically regulating each type of transport equipment should be considered when financing such equipment.

Shipping

The Maritime Navigation Act regulates the main aspects of shipbuilding contracts and sale and purchase agreements. Although the provisions are not mandatory, the shipbuilder cannot be exonerated from liability in the event of wilful misconduct or gross negligence.

Spain has a dual registration system for ships, vessels and naval artefacts: the Ship Registry and the Chattel Registry. The Ships Registry is the administrative registry for registering vessels that fly the Spanish flag. Vessels flying the Spanish flag are bound by Spanish tax, employment, documentation and safety regulations. There is also a second administrative ship registry named the Special Registry of Ships and Shipping Companies located in the Canary Islands (REBECA).

The Chattel Registry is a private registry that contains information in its ships section regarding the ownership and encumbrance of ships, vessels and naval artefacts to provide legal certainty in related matters. Third parties have standing to challenge information registered in the Chattel Registry.

All ships, vessels and naval artefacts, including those under construction, may be subject to a ship mortgage pursuant to the provisions of the Maritime Navigation Act and the International Convention on Maritime Liens and Mortgages signed in Geneva on 6 May 1993. The ship mortgage must be registered with the Chattel Registry to be valid and enforceable, and to have third-party effects.

When financing the construction of a vessel in Spain, the Spanish tax lease system (STLS) for the financing of assets, which in particular affects the financing of vessels, should be taken into consideration. In the judgment handed down on 17 December 2015, the General Court annulled Commission Decision No. 2014/200/EU, which held that the STLS

constituted illegal state aid and, therefore, gave recognition to it. Although the Commission has appealed the judgment before the EU Court of Justice, the General Court's judgment is an endorsement of the STLS, which may have a substantially positive impact on the Spanish naval industry.

The STLS is based on the tax depreciation of leased assets. The STLS's general contractual structure is as follows: a builder (the builder) and a leasing entity (the lease company) enter into a shipbuilding contract for the construction of a vessel, as negotiated in commercial terms between a shipowner (the shipowner) and the builder. The lease company and an economic interest group (EIG) enter into a finance lease agreement with a purchase option. In turn, the EIG and the shipowner enter into a bareboat charter agreement permitting the use of the vessel by the latter after delivery. At a subsequent stage, the shipowner buys the vessel from the EIG and becomes its owner. In addition, Royal Decree 874/2017 regulates interest-rate subsidies for credits for vessel constructions.

Aviation

Spain has not passed any act specifically regulating the construction, acquisition or financing of aircraft.

After the amendments introduced by Royal Decree 384/2015 of 22 May, aircraft operated by Spanish operators must be registered with the Aircraft Matriculation Registry and the Chattel Registry. Registration of an aircraft with the Aircraft Matriculation Registry confers Spanish nationality as well as the applicable tax and safety provisions, while the Chattel Registry records ownership and encumbrances affecting the aircraft and has third-party effects.

Apart from the above, Spain has ratified the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, signed in Cape Town on 16 November 2001.

The result is that Spain has a triple registration system, with aircraft also potentially being registered with the International Registry set up by the Cape Town Protocol to Aircraft Equipment. International interests created pursuant to the Cape Town Protocol are enforceable in Spain.

Among its declarations to the Cape Town Protocol to Aircraft Equipment, Spain designated the Chattel Registry as the entry point to the International Registry.

That Spanish entry point has been set up as an authorising entry point (i.e., the Chattel Registry only authorises the transfer of mandatory information to the International Registry for the registration of an international interest by issuing a code). After obtaining that code, the parties are entitled to register, and therefore claim, an international interest in the International Registry by providing the required information electronically.

Furthermore, the creditor secured by an international interest is not entitled to take self-remedy actions unless it holds an Irrevocable De-Registration and Export Request Authorisation (IDERA). According to the Spanish Declaration to the Cape Town Protocol to Aircraft Equipment, the holder of an IDERA is authorised to request deregistration and export of an aircraft without obtaining judicial authorisation.

Although the Chattel Mortgages and Non-dispossessionary Pledges Act of 16 December 1954 regulates chattel mortgages over an aircraft, in practice they will no longer be used in Spain in the near future as international interests take priority over any national interest created after 1 March 2016.

The main rules governing the management and legal status of RPAs (formerly governed by Act 18/2014 of 15 October) have recently been updated by Royal Decree 1036/2017.

Rail

Spain has not enacted any provision that specifically regulates the financing, construction or acquisition of rolling stock. As with shipping transport equipment, rolling stock must be registered with the Special Railway Registry, an administrative registry. Registration of rolling stock with the Chattel Registry is optional.

Regarding interests, chattel mortgages can be created over private wagons and over public and private locomotives, as established by the Chattel Mortgages and Non-dispossessionary Pledges Act.

Spain is not expected to ratify the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock signed on 23 February 2007.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

The provisions of Basel III were implemented into the legal framework of the European Union, mainly through: (1) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV); and (2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR).

CRD IV has been implemented into Spanish law through: (1) Law 10/2014 of 26 June on the organisation, supervision and solvency of credit institutions; (2) Royal Decree 84/2015 of 13 February, which implements Law 10/2014 of 26 June on the organisation, supervision and solvency of credit institutions; and (3) Circular 2/2016 of 26 February, of the Bank of Spain, to credit institutions, on supervision and solvency, completing the adaptation of Spanish domestic law to Directive 2013/36/EU and Regulation (EU) No. 575/2013.

The above legal framework imposes requirements on credit institutions in the following areas, among others: (1) own funds and capital buffers; (2) measure and management of risks; (3) large exposures; (4) liquidity and (5) leverage.

In November 2016, the European Commission published a proposal to both CRD IV and CRR (the 'CRD V' and 'CRR II'). The key elements of the proposal relate to the leverage ratio, the net stable funding ratio, the total loss-absorbing capacity, the Basel Committee's work on capital requirements of institutions that trade in securities and derivatives and other amendments intended to make the existing rules more proportionate, to ensure their compliance by small and non-complex institutions. Although it was expected that the European Council and the Parliament would have concluded these new reforms by the end of 2018, the proposed amendments are still being discussed.

ii Supervisory regime

Since the establishment of the Single Supervisory Mechanism in 2014, the supervision of credit entities in Spain is shared between the European Central Bank (ECB) and the

Bank of Spain in the terms set out under Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (the SSM Regulation). According to the SSM Regulations, the ECB has exclusive competence to carry out certain tasks for prudential supervisory purposes. For instance, it is responsible for granting and withdrawing authorisations for the establishment of credit institutions in the eurozone, assessing notifications for the acquisition and disposal of qualifying holdings, performing stress tests, supervising on a consolidated basis and ensuring banks' compliance with EU prudential requirements, such as own-funds requirements, liquidity, leverage or corporate governance.

However, for the sake of efficiency, supervisory tasks and responsibilities are allocated to the ECB and the Bank of Spain depending on the bank's significance in accordance with the SSM Regulation and Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities. The conditions for a bank to be considered as significant are established in the SSM Regulation and such conditions are published by the ECB and the Bank of Spain.

IV SECURITY AND ENFORCEMENT

Access to financing in the maritime, aircraft and railway sectors is a key factor for success in the current commercial context. The indebtedness that companies operating in those sectors must assume for the construction, financing and acquisition of vessels, aircraft and rolling stock depends on the companies' capacity to provide sufficient and adequate security to the financing entities. The security package is therefore essential in asset finance. In Spain, a mortgage over the financed asset is normally granted as security to the lenders and has an important economic function and an essential role in new building projects. The entry into force of the Maritime Navigation Act, representing a significant modernisation of Spain's former maritime regulation, establishes the legal framework governing ship mortgages. Mortgages over aircraft and rolling stock are also subject to specific regulations. Moreover, as previously mentioned, Spain is a party to various international conventions that apply to these types of guarantees, including the International Convention on Maritime Liens and Mortgages (1993) and the Cape Town Convention on international interests in mobile equipment.

i Financing of contracts

Shipping

The ship mortgage is the basic security normally granted within the scope of shipbuilding projects, but not the exclusive form, as ancillary security such as refund guarantees and pledges are also commonly used. The legal framework governing ship mortgages is primarily contained in articles 126 to 144 of the Maritime Navigation Act, substituting Spain's previous framework on these types of security, and in the International Convention on Maritime Liens and Mortgages (1993).

There are two requirements under the Maritime Navigation Act for a ship mortgage to be validly created as a right *in rem* with effects against third parties: (1) it must be documented in writing in either a private or public document; and (2) it must be registered within the Chattel Registry. To create and register the mortgage over a vessel under construction, a third

of the budgeted amount of the total hull value must have been invested and the ownership of the vessel registered with the Chattel Registry. The parties to the ship mortgage are the mortgagee (normally a bank financing the construction of the vessel) and the mortgagor (which can be the debtor under the financing contracts or another party, as the mortgage can be granted as security of third-party obligations).

In respect of the asset, the mortgage extends to both the vessel's component parts and fittings, but not accessories. The mortgage also covers licences linked to the vessel (such as fishing licences), compensation arising from insurance and from material damage to the vessel owing to collision or other accidents. In respect of the secured obligations, unless otherwise agreed, a mortgage granted as security of a credit that accrues interest will not exceed (to the detriment of a third party) the interest of the previous two years elapsed and the matured part of the current annual dues, in addition to the principal.

If a definitive change of the vessel's flag is intended, it may not be carried out unless all mortgages, charges and encumbrances have been cancelled or the written consent of the beneficiaries of the mortgages, charges or encumbrances has been granted. Temporary changes of flag will not affect the regulation applicable to the mortgage, which shall continue to be the act applicable under the flag flown by the vessel at the time the mortgage was granted.

Aviation

Aircraft finance can also be secured by granting a mortgage over the asset. The legal framework applicable to this kind of mortgage is primarily established in the Air Navigation Act and in the Chattel Mortgages and Non-dispossessionary Pledges Act. The mortgage must be registered with the Chattel Registry for its valid creation and the security must also be registered with the Aircraft Matriculation Registry. To be able to create and register the mortgage over an aircraft during its construction, a third of its budgeted amount must have been invested in the same. The aircraft must be identified in the mortgage deed by including, among other details, the following information: (1) registration number given to the aircraft by the Aircraft Matriculation Registry; (2) stage of construction (if the aircraft remains under construction); (3) domicile of the aircraft; and (4) insurance policies covering the aircraft. The mortgage extends to the airframe, engines, radio and navigation devices and accessories. The mortgage can also extend to spare parts, provided they are listed in the mortgage deed.

Spain adhered to the Cape Town Convention in 2013, although it was not until 15 December 2015 that Spain adhered to the Aircraft Protocol, which entered into force in Spain on 1 March 2016. The Cape Town Convention contains the general framework applicable not only to securities over airframes, engines and helicopters, but also to other mobile equipment such as railway rolling stock and space assets (specific protocols are established for each type of mobile equipment). The Aircraft Protocol completes the Convention with specific terms and provisions regarding international interests in mobile equipment on matters specific to aircraft equipment. Thus, security can also be granted in the form of international interest over airframes, engines and helicopters, in accordance with the requirements under Article 7 of the Convention. The Convention also created an International Registry (Article 16) for the registration of, among others, international interests, prospective international interests, assignments and prospective assignments of international interests and acquisitions of international interests.

Rail

If a wagon or locomotive is privately owned, a chattel mortgage can be granted as security in accordance with article 12.2 of the Chattel Mortgages and Non-dispossessionary Pledges Act. Chattel mortgages cannot be granted over wagons owned by the state. However, a pledge without displacement or 'non-possessory pledge' over wagons, or a chattel mortgage over locomotives, may be granted instead.

ii Enforcement

Article 140 of the Maritime Navigation Act lists specific events that will entitle the mortgagee to enforce its right against the vessel with a subsequent judicial sale of the same (see Section IV.iii). Those events are: (1) expiry of the term agreed to return the principal or interest; (2) the debtor's declaration of insolvency; (3) deterioration of the mortgaged vessel rendering it definitively unseaworthy; (4) the existence of two or more vessels mortgaged to fulfil the same obligation and where a loss or deterioration arises that renders either of them definitively unseaworthy; and (5) the occurrence of any of the agreed termination events.

Upon the occurrence of any of the above events, the mortgagee has various alternatives available to enforce the mortgage, basically consisting of: (1) ordinary declarative proceedings; (2) general rules for enforcement proceedings; (3) special enforcement proceedings on mortgaged assets; and (4) non-judicial enforcement proceedings before a notary public. The action to enforce a ship mortgage has a limitation period of three years, which runs from the date on which any of the above events occur.

The enforcement of a mortgage over aircraft or rolling stock is not subject to specific regulations under Spanish law. Thus, the general rules for enforcement in the Civil Procedure Act apply.

If the mortgagee initiates the special enforcement proceedings on mortgaged assets (articles 681 to 698 of the Civil Procedure Act), the claim for the due amounts secured with the mortgage can be exercised directly against the mortgaged asset itself. There are various formal requirements that must be fulfilled to initiate the proceedings, which essentially consist of the following: (1) the price of the mortgaged asset must be indicated in the mortgage deed so that it can be used as a reservation price in the auction of the asset; and (2) the debtor's domicile must be indicated in the mortgage deed (for notification and communication purposes).

iii Arrest and judicial sale

Shipping

Conservatory arrest of both domestic and foreign vessels is governed by the International Convention on the Arrest of Ships made in Geneva on 12 March 1999, articles 470 to 479 of the Maritime Navigation Act and by the Spanish Civil Procedure Act. The provisional court measure causes the detention and immobilisation of the vessel. The court with jurisdiction regarding subject-matter to hear the main claim on the merits, or the court with territorial jurisdiction corresponding to the port or place where the vessel is located (or expected to arrive), will order the vessel's arrest. The arrest cannot be effected to ensure the enforcement of a previous judgment or arbitration award: arrest is a provisional ancillary measure for the main claim.

The arrest is conditional on the fulfilment of the following requirements: (1) alleging the existence of a maritime claim and its cause; (2) the vessel to be arrested is eligible for arrest under Article 3 of the Convention; and (3) the claimant must provide security to cover any

loss that may be incurred by the defendant as a result of the arrest, and for which the claimant may be found liable. Pursuant to article 472.2 of the Maritime Navigation Act, the amount of the security shall be at least 15 per cent of the amount of the maritime credit alleged.

Once the arrest has been ordered, the court will notify the harbour master of the port where the vessel is located (or expected to arrive) and will take the necessary measures to arrest and prohibit the vessel's departure. The arrest must also be notified to the vessel's master or shipping agent.

The judicial sale of a vessel is governed by the International Convention on Maritime Liens and Mortgages, made in Geneva on 6 May 1993 (the 1993 Geneva Convention), articles 480 to 486 of the Maritime Navigation Act and, for matters not expressly addressed by those acts, by the Civil Procedure Act. Prior to the forced sale of the vessel, the court must give notification of the sale of the vessel at least 30 days prior to the date on which the forced sale is intended. The notification must be directed to: (1) the registrar of the Chattel Registry and, if relevant, to the authority in charge of the registration of the vessel under a temporary change of flag; (2) the owner of the vessel; and (3) the mortgagees and holders of other encumbrances, including those established in Article 4 of the 1993 Geneva Convention (provided that the court has received notification of the corresponding credits).

The court's notification must state the date and place the forced sale is to be carried out or, if it cannot be stated with certainty, the approximate date and place. The proceeds from the forced sale must first be used to pay the procedural costs and expenses arising from the arrest, or the enforcement and subsequent sale of the vessel (e.g., expenses arising from the upkeep of the vessel and the crew as well as wages, other sums and costs referred to in Article 4, Paragraph 1(a) of the 1993 Geneva Convention, incurred from the time of arrest or seizure). The remaining amount will then be distributed according to the terms and provisions of the 1993 Geneva Convention.

Aviation

Aircraft are also subject to arrest, which is governed by the Civil Procedure Act. However, there are specific particularities under Spanish law and international conventions ratified by Spain that render the cautionary measure of arrest unattractive in practice. Article 132 of the Air Navigation Act establishes that the arrest of aircraft owned by air traffic companies may not interrupt the public service for which they are operating. The same rule is established under the Convention for the Unification of Certain Rules Relating to the Precautionary Arrest of Aircraft, adopted in Rome on 29 May 1933.

V CURRENT DEVELOPMENTS

The main legislative development in the aviation sector was the entry into force in Spain of the Aircraft Protocol to the Cape Town Convention on 1 March 2016. Furthermore, the Directorate General for Registry and Notary Offices of the Ministry of Justice issued a resolution on 29 February 2016 with the aim of approving specific forms to facilitate access to the International Registry by means of the Spanish entry point, the Chattel Registry. Spain has also submitted declarations to the Convention, which entered into force on 1 June 2016. These declarations are made pursuant to Article 39 (rights having priority without registration), Article 40 (registrable non-consensual rights or interests) and Article 53 (determination of courts).

Currently, Spain faces the challenge of performing all the necessary internal amendments to ensure that the entry into force of the Cape Town Convention, and specifically the international interest enforcement, is implemented in the most effective manner. In any event, Spanish intervening agents (e.g., public bodies, registrars) are taking significant steps for the correct implementation of the Cape Town Convention. These developments may have a significant positive impact on Spain's aviation financing sector.

Turning to the maritime sector, Spanish ports are receiving an increasing number of traffic containers, consolidating their leading position by traffic volume within Europe. With regard to the shipping financing industry, the fact that the new Spanish tax lease framework was upheld by the judgment of the EU General Court together with the approval of Royal Decree 874/2017, gives an optimistic view of the future.

In the railway sector, Spain has effected the transposition of the market pillar of the Fourth Railway Package, commencing with the approval of Royal Decree-Law 23/2018. Thus, passenger railway transport has been open to competition as of 1 January 2019, meaning that any railway company can request capacity for the working timetable starting on 14 December 2020.

Although no official announcement has been published yet, it seems that Spain has extended the period to transpose Directives 2016/797 and 2016/798 by one year. Should this be the case, the transposition of the technical pillar would have to take place by 16 June 2020, rather than by 16 June 2019.

The procedure for enacting a Royal Decree on railway operational safety and interoperability, under which both Directives are envisaged to be implemented, has already completed the public consultation phase – a mandatory step prior to its approval.

UNITED KINGDOM

Kenneth Gray, Richard Howley and Tom Johnson¹

I INTRODUCTION

i Aviation

England is one of the major jurisdictions concerned with the financing of aircraft on account of the position of the City of London as the major international financial centre, the pre-eminence of English law as the governing law for international contracts and the importance of the aviation industry within the United Kingdom.

The aviation industry in the United Kingdom can be divided into manufacturing, operating and financing, each of these underpinned by English law and English lawyers.

The United Kingdom is the second-largest exporter of aerospace equipment in the world, both from domestic manufacturers, such as Rolls-Royce and British Aerospace and from foreign corporations working through United Kingdom plants, including Airbus and Boeing.

New aircraft require financing running into the hundreds of billions of dollars annually. A very large proportion of this will be provided by banks and financial institutions lending from their offices in the City of London.

Finally, with British Airways and easyJet, the United Kingdom is home to two of the largest carriers in Europe, both having substantial financing needs.

Commercial bank lending for aircraft fell dramatically after 2008, but aircraft deliveries continued to increase, even during the recession. Funding is now largely split evenly between own funds, the capital markets and commercial banks.

Brexit may have a huge impact on the aviation industry in the United Kingdom, though the effect on the finance aspects of the industry will be limited.

ii Shipping

Ships carry something like 90 per cent of the world's trade. This includes dry bulk cargoes (such as grain, coal, iron ore and other raw materials), liquid bulk cargoes (such as liquefied gas, crude oil, refined oil products and chemicals), foods (often in refrigerated ships) and finished products (in ships such as car carriers and container ships). Ships and other vessels also participate extensively in offshore oil and gas exploration, development and production and provide platforms for leisure activity (the cruise business) and for transportation of passengers, and private and commercial vehicles.

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London is the world's leading centre for the provision of shipping services such as broking, insurance, finance, legal and arbitration, ship management and technical advice.

Despite the decline in the United Kingdom-registered merchant fleet relative to some other leading maritime nations during the post-war period, the United Kingdom also remains a significant base for ownership and control of ships, particularly through the growth in United Kingdom-based tonnage credited to the United Kingdom tonnage tax scheme. British overseas territories such as Bermuda and Crown dependencies such as the Isle of Man also have substantial fleets of merchant ships registered with them.

Shipping is predominantly financed by a combination of shareholder funding (private or public) and bank or lessor, or (for new ships) export credit agency-backed lending secured by mortgages over ships and related rights, with a significant – albeit often cyclical – contribution of funding from debt capital markets, principally within the United States and Norway.

London is one of the leading centres for financing the global shipping industry and hosts shipping teams from domestic banks in the United Kingdom and, very significantly, foreign banks (such as the United States, Far Eastern, continental European and Scandinavian banks). These banks arrange and extend secured lending and ancillary financial services and also provide structuring and advisory services for other financing products (such as leasing, public and private equity, debt capital markets and derivatives).

iii Rail

The rail sections of this chapter consider the financing of passenger rolling stock in the United Kingdom (excluding Northern Ireland) other than light rail or subway systems. This activity may be viewed with interest internationally in terms of contributing to an understanding of how a privatised railway might be financed and the opportunities this presents. In the United Kingdom, passenger rolling stock tends to be owned by specialist owning companies and not by train operators. There are three principal rolling stock owners,² which each own a substantial portion of the passenger rolling stock on the system, although in recent years the market has attracted attention from alternative financiers. ROSCOs will typically buy rolling stock from the manufacturer in a tripartite arrangement with the initial operator of the rolling stock. The purchase is funded by equity or debt, under corporate facilities or sometimes a specific facility. The rolling stock is then leased to successive operators of the rolling stock under franchises. The ongoing Williams Rail Review will look closely at the franchising system, and may replace it in due course. Further clarification is awaited.

The ROSCOs' source of funding has changed since privatisation. Bank debt has always played a part, particularly when the ROSCOs were all owned by banks. Over the past few years, however, there has been a significant shift in the equity interest with investment in ROSCOs coming from private equity, pension funds and foreign strategic investors. The attractions include a long-term steady return on investment coupled with attractive forecasts of rail growth and opportunities to extend the life of existing rolling stock.

² Eversholt Rail group, Angel Trains group and Porterbrook group – known by the acronym ROSCOs.

II LEGISLATIVE FRAMEWORK

Other than the recent implementation of the Cape Town Convention into law, there is no specific legislation governing the financing of aircraft, ships or rolling stock.

The United Kingdom ratified the Cape Town Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment (together, the Cape Town Convention) with effect from 1 November 2015 (see below). The government of the United Kingdom is also considering the ratification of the Protocol on Railway Equipment, but no timetable has been set for this.

English common law is an internationally accepted choice of law for financing aircraft, ships and, to a lesser extent, rolling stock, whether the financing is arranged out of London or other industry or financial centres. English-qualified lawyers serving the transportation and asset-financing community are located in London and across the globe.

However, laws of countries where assets are registered or other related assets and rights are located will also be relevant in most financings and the insolvency regimes applicable to transportation companies based in other countries will also be relevant.

Domestic and international law and regulation

Aircraft

The leasing and mortgaging of aircraft is subject to standard common law principles. In addition, institutions benefiting from a mortgage over an aircraft registered with the Civil Aviation Authority of the United Kingdom (CAA) may protect their priority thereunder by registering it on the Register of Aircraft Mortgages maintained by the CAA in accordance with the Mortgaging of Aircraft Order 1972.

The government legislated for the Cape Town Convention pursuant to the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the Cape Town Regulations), which came into force in November 2015. The Cape Town Convention is intended to:

- a* facilitate the acquisition of financing of aircraft by providing for the creation of a *sui generis* ‘international interest’ in aircraft;
- b* provide for a range of default and insolvency-based remedies to be available to creditors under international interests; and
- c* provide for an international registry in which international interests may be registered, so guaranteeing their priority,

The relationship between the Cape Town Regulations, the Mortgaging of Aircraft Order, 1972 and other English domestic law is a complex one and depends on a number of factors, including timing, the location of the parties, the situs of the aircraft at any given time and the state of registration of the aircraft. Different principles may apply to airframes and to engines.

The ratification of the Cape Town Convention and the passage of the Cape Town Regulations has had a significant impact on the finance documents relating to aircraft registered in the United Kingdom. Although the Cape Town Convention is heavily influenced by common law doctrine on the creation of security over and leasing of assets, there are certain variations from English law that will need to be reflected in the financing documentation.³

³ A full discussion of the effects of the Cape Town Convention can be found at www.awg.aero.

One particular benefit of the ratification of the Cape Town Convention is that creditors wishing to obtain security over an aircraft under English law may be able to do so, to the extent that the Cape Town Convention applies, by obtaining an international interest under the terms of the Cape Town Convention rather than by means of an English-law mortgage. The common law *lex situs* requirement (that a mortgage over an aircraft must be created in accordance with the laws of the jurisdiction where the aircraft is situated at the time of its creation) does not apply to international interests created under the Cape Town Convention.

The Cape Town Convention is a 'mixed agreement'; that is to say, parts of it (such as those provisions relating to insolvency) are within EU competence while other parts (such as those relating to the establishment of the International Registry) are within the competence of Member States. Accordingly, it has been ratified by both the EU and the United Kingdom. A complex question is what further steps should be taken by the United Kingdom following Brexit.

Ships

Ships benefit from a system of registration established under the laws of maritime countries that, *inter alia*, provide mechanisms for recording legal ownership, mortgages over ships and priority between different mortgages.

When lying in port or in a country's territorial waters, ships are subject to arrest and possible sale as security for contractual and other claims relating to them or other ships under common ownership or, in some countries, control (as well as ship mortgage claims). The types of maritime claim that can be protected and enforced in this way and the priority they will have among themselves and against registered ship mortgages will usually depend on the local law where the ship is located.

Rail

There are special rules relating to the process following a railway company going into administration, but in general, rolling stock is subject to the general laws relating to movable possessions. There is no rolling stock title.

In the United Kingdom, there has been concern that ROSCOs are making excessive profits from their rolling stock leases. The most recent major competition authority investigation found these concerns to be unfounded and recommended only small changes to ROSCO practices, rather than the need for specific regulation.

The operational side of the railway industry in the United Kingdom has been generally governed by Directives of the European Union, of which there have been three (with a fourth in the process of being adopted) dealing specifically with the structure and operation of railways in the European Union. The United Kingdom generally complies with these Directives (although divergences may appear after the United Kingdom leaves the European Union), but they do not have any direct impact on the financing of the rolling stock.

Of potentially more relevance to the financing of rolling stock is the ongoing government review of the rail industry (the Williams Rail Review), which could be far reaching and may alter the industry structure and operation significantly.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Regulation No. 573/2013 of the European Union on prudential requirements for credit institutions and investment firms (the Capital Requirements Regulation or CRR) came into force on 1 January 2014 and implements the provisions of Basel III. Its provisions will become applicable progressively over a period ending in 2019. The CRR is intended to ensure that losses incurred by banks on their trading and lending books do not require bailouts by taxpayers and that depositors' rights are safeguarded. The CRR does this in a number of ways, of which the following specifically affect the financing of transportation assets.

First, the CRR requires banks to hold a minimum amount of regulatory capital (see below) against their risk-weighted assets. For security over a tangible asset to be eligible to reduce the risk-weighting of a corresponding loan, a number of conditions need to be met, including those concerning the availability of data on the market value of the asset and the liquidity of the resale markets. In practice, this means that aircraft are more likely to be eligible as collateral than other tangible assets.

Second, the CRR increases the quantity and quality of regulatory capital that a bank is required to hold against its risk-weighted assets (including its loan book). Common equity is substantially prioritised over other types of regulatory capital, such as subordinated loans and capital markets instruments. The amount of common equity required to be held varies according to the size of the bank and the prevailing economic conditions in its jurisdiction, but will increase by a factor of between 350 per cent and 650 per cent over the pre-CRR requirements. The increase in the amount of common equity that a bank is obliged to account for against a particular loan will have an inevitable effect on the pricing of that loan.

Third, in addition to the new risk-weighted ratios, a new leveraged ratio will be introduced that does not take account of the risk weighting of any particular asset. The level of the new ratio is yet to be set but a consequence is that certain transactions (particularly those involving export credits or that otherwise benefited from a low risk weighting) will need to be reviewed by banks in that they will have greater consequences on their balance sheet treatment than is currently the case.

Fourth, two new liquidity ratios will be introduced:

- a* the liquidity coverage ratio, which provides (in essence) that banks must hold enough high-quality assets to meet their obligations over 90 days in a stress situation; and
- b* the net stable funding ratio, which provides that banks should fund long-term loans (by which is meant a loan with a maturity in excess of one year) from equivalent long-term sources, making short-term corporate loans more attractive than longer-term loans into the transport sector.

The cumulative effect of these provisions has been to dampen banks' appetite for long-term debt, even when attractively secured. There have been several instances of banks deleveraging.⁴ That said, bank lending into the transport sector has recently been on the increase so it may turn out that the fears as to the impact of the CRR have been exaggerated.

⁴ Selling their asset finance portfolios in an attempt to free up their regulatory capital.

In December 2017, the Basel Committee on Banking Supervision published a paper – Basel III: Finalising Post-crisis Reforms – containing proposals that will significantly change the framework for calculating bank regulatory capital requirements in the asset finance sector. It is due to be implemented progressively from 2022.

ii Supervisory regime

Banks in the United Kingdom are supervised by the Financial Conduct Authority and the Prudential Regulation Authority. The CRR is the principal legislation affecting banks' ability to lend into the transport sector.

IV SECURITY AND ENFORCEMENT

i Security

Aircraft

Lenders require a first priority mortgage (or equivalent security) over an aircraft that is enforceable in every relevant jurisdiction. Problems arise, however, where different jurisdictions have different rules as to how security over a particular aircraft should be created. For example, under English law, before the Cape Town Convention was implemented, the validity of proprietary rights over aircraft had to be determined in accordance with the *lex situs* – the laws of the jurisdiction where the aircraft is situated at the time the security was created. That is still the case except to the extent that rights are created under the Cape Town Convention. However, under French law, the laws of the state of registration would be determinative of the issue.

It is common practice in some situations for an English law mortgage to be executed over an aircraft while it is in English airspace and, possibly, a mortgage governed by the laws of the state of registration of the aircraft (often referred to as local law mortgages) when it is physically situated there.

Local law mortgages are often problematic because:

- a* there may be no legal framework for their creation (for example, in Belgium);
- b* there may be prohibitive stamp duty payable on their registration (for example, in Spain);
- c* there may be restrictions on the identity of the creditor to whom they may be given (for example, in Colombia); or
- d* their enforcement before the local courts may present practical problems in terms of timing and judicial risk.

It is for these reasons that an English law mortgage is often required instead of, or in addition to, a local law mortgage. However, parties need to consider in which jurisdictions such an English law mortgage over a foreign-registered aircraft would be recognised.

Security over aircraft may now also be created under English law by creating an international interest under the Cape Town Convention to the extent that it applies. It will apply if either the debtor is situated in a contracting state or, to a limited extent, if the aircraft is registered in one.

If an individual aircraft is owned by a special purpose company, it is common for the lenders to take security over the shares in that company.

Shipping

The main security will generally be a ship mortgage (governed by the laws of the ship's state of registry), supplemented by security over the ship's earnings and insurances, any compensation that may be due if the ship is ever confiscated by its state of registry (e.g., in time of war) and, sometimes, a significant charter of the ship.

It is also common for lenders to take security over bank accounts into which a ship's earnings are to be paid or reserved.

When financing a ship that is still under construction (and therefore cannot yet be registered and mortgaged by its intended owner), lenders will take security over the buyer's rights under the shipbuilding contract and any related guarantees or security provided to the buyer for the shipbuilder's obligations.

Lenders may also take security over the shares of a single-purpose, single ship-owning company.

Rail

There being no specific legislation concerning the legal nature of rolling stock or protecting its title or for the creation of security over rolling stock, rolling stock falls to be dealt with in the same way as any other movable property.

A corporate owner may create a mortgage or charge over rolling stock in favour of a lender and that mortgage or charge should be registered on the Companies House charges register of the mortgagor or chargor.

There being no statutory protections, it was common in the early days of privatisation, in order to protect title to rolling stock, for notices to be fixed to rolling stock to ensure nobody could claim not to have notice of the ownership, as that lack of notice could defeat the claims of the true owner. However, such is the level of clear identification of each rolling stock vehicle and of the tracking of the daily movements of each vehicle, that the risk of loss of vehicles in this way is minimal.

ii Financing of contracts

Aviation

Airlines wishing to finance new aircraft will normally issue a request for proposals seeking offers from financial institutions to finance the relevant aircraft. There are a number of common structures that are often established for financing purposes, including:

- a* a finance lease, in which the aircraft is owned by an orphan trust and leased to the airline;
- b* export credit financing, in which the export credit agency of the state where the aircraft is manufactured provides support for its financing;
- c* purchase and leasebacks, in which, following delivery of the aircraft by the manufacturer to the airline, the latter immediately on-sells it to an operating lessor and takes it back on operating lease; and
- d* capital markets-based structures, such as the Enhanced Equipment Trust Certificate.

Increasingly, operating lessors buy aircraft directly from manufacturers for immediate use in their leasing business.

Shipping

For ships under construction, typically, the buyer will pay between 20 and 50 per cent of the contract price from equity or debt by stage payments. The builder funds the construction and is paid the balance on delivery, which may be funded by export credit agency-supported debt (perhaps at a fixed rate).

Rail

Typically, rolling stock is procured at the behest of a franchised operator who needs more rolling stock. The contract for manufacture is normally tripartite, with the ROSCO taking title and paying the stage payments. The ROSCO will fund the purchase from equity or from general corporate, or specific debt, facilities, and will negotiate the payments required to service that debt as part of the lease discussions with the operator. Although the operator might be required to undertake a proper competitive tender procurement exercise for the rolling stock, the financing will normally be arranged privately by the operator approaching one or more ROSCOs.

On occasion, rolling stock is financed directly by an operator group, but this carries risks for the financier, which are reduced significantly if the ROSCO is the borrower. It is unlikely that an operator will hold the necessary franchise for the operation of the rolling stock for its full useful life, giving rise to risks with regard to the repayment of the debt. Rolling stock might also be purchased, not necessarily via a ROSCO, for the purposes of a specific project, in which case there will be a specific allocation of risks between the parties.

The owner of rolling stock is normally required to enter into an agreement with the franchising authority (currently the Department for Transport), ensuring the continued availability of the rolling stock for the franchised railway system and restricting rights of disposal. Similar arrangements may apply on specific projects.

iii Enforcement

The general English law approach to the enforcement of security over assets is one of self-help, relying on the contractual terms of the security without the need to enlist the aid of the court. Other laws, however, may not allow lenders the full range of self-help remedies and may require judicial authorisation and, possibly, the enforcement of security through a court-supervised public auction. There are certain specific concerns for aircraft, ships and rail equipment.

All of these enforcement methods may be restrained if the owner of the asset is subject to insolvency procedures that restrain creditors from enforcing security (such as administration in the United Kingdom and Chapter XI proceedings in the United States).

Aviation

Countries ratifying the Cape Town Convention are encouraged (but not required) to adopt self-help remedies for creditors in respect of aircraft equipment and also to adopt Chapter XI-style insolvency proceedings for airlines under their jurisdiction under 'Alternative A' procedures. Under these procedures, defaulting airlines will be required to remedy a default within a specified waiting period or, if not, hand the aircraft back to the creditor. The United Kingdom has adopted the Alternative A procedures, supplementing the administration framework currently in place (which requires the creditor to obtain court consent before repossessing the aircraft).

Creditors seeking to repossess aircraft also need to be aware of possible third-party creditors of the airline who may be able to claim liens, or detention rights, over the aircraft at law. Who these creditors consist of is a matter for the laws of the jurisdiction where the aircraft is situated at the relevant time. Common categories include repairmen, airports and air navigation authorities and unpaid salaries and taxes.

Shipping

The most common method of enforcement is to seek the arrest of the ship while in port and request that the local court sell the ship, usually by some form of auction process. The court will then distribute the net proceeds (after expenses) to the mortgagees and others with maritime claims against the ship. This method is favoured because such a sale is generally recognised in maritime countries as freeing the ship from existing encumbrances and debts.

If a ship is not sold through a court in this way then existing liabilities could potentially be left in place and, as a result, a potential buyer is likely to require warranties and indemnities from a creditworthy person against the existence and consequences of such liabilities (which a lender will probably be unwilling to give).

If self-help remedies are available under the laws of the ship's state of registry, other options may be to sell the ship as mortgagee or to take possession of it. Selling a ship privately as mortgagee will, however, only clear the ship's title of registered mortgages and not other types of maritime claim. Obtaining possession raises practical difficulties but, having achieved it, exposes the lender to the risk of claims arising from accidents or pollution incidents involving the ship during its possession, as well as responsibility for bearing the costs of insuring, maintaining and conserving the ship. Procedures and practices for arrest and sale of ships vary from country to country and some are considered more favourable to a speedy and efficient process than others.

Rail

When taking security over rolling stock used within the franchised railway system, the security holder is required to agree with the franchising authority that the rights to enforce the security are subject to rights of the franchising authority to take on the leasing of the rolling stock (similar arrangements may apply on specific projects). Where franchised operators have failed to date, the failure has been at the franchise contract performance level and not at the corporate level, and the arrangements in place for keeping the railway operating have ensured the continued use of and payment for rolling stock, so no enforcement action has been taken against rolling stock for borrower default.

There are special rules relating to the administration of a railway company, intended to ensure that the rolling stock owned or operated by that company remains active in the franchised railway system.

iv Arrest and sale

All relevant issues relating to the arrest and sale of aircraft, ships and rolling stock are dealt with in Section IV.iii.

V CURRENT DEVELOPMENTS

i Recent cases

While there have been few cases relating specifically to the financing of ships or rolling stock, the English courts have been confronted by a plethora of cases in the aviation sector. These cases include:

- a* the *Blue Sky* case⁵ relating to the *lex situs* rule for the creation of proprietary interests in aircraft;
- b* the *Alpstream* case⁶ on the duties of mortgagees of aircraft;
- c* the *Pindell* case⁷ on remedies for failure to redeliver aircraft in the right condition;
- d* the *Paramount* case⁸ on the applicability of the doctrine of relief from forfeiture to aircraft leases;
- e* the *ACG v. Olympic* case⁹ on the risk of latent defects in aircraft at delivery; and
- f* the *Global Knafaim* case¹⁰ on the detention rights of the CAA and Eurocontrol.

It is an empirical fact that the aircraft finance and leasing sector is becomingly increasingly litigious.

ii Developments in policy and legislation

Aviation

The main legal development in the aviation sector in the United Kingdom has been the ratification of the Cape Town Convention, which has already been discussed.

Export credit finance for aircraft has been largely put on hold as a consequence of political problems at Eximbank and European export credit agencies. The resulting void has been partly filled by the use of structures known as AFIC (for Boeing aircraft) and Balthazar (for Airbus products) in which the export credit agencies are replaced by commercial credit insurers.

The aviation industry is one for which Brexit poses particular challenges. The European ownership of British airlines (and British ownership of other European airlines) may no longer be viable. The access of British airlines to foreign markets – for example to North America via the open skies agreement or within Europe by virtue of European skies – is also at risk. British airlines may no longer be able to benefit from ‘horizontal agreements’: aircraft services agreements between third-party countries and another EU state, which have been extended to the United Kingdom. The basis for the United Kingdom’s continued interaction with the European Air Safety Agency will need to be established. A host of regulations (for example, relating to compensation or wet leasing) will also need to be reconsidered.

5 *Blue Sky One Limited & Ors v. Mahan Air & Anor* [2010] EWHC 631 (Comm).

6 *Alpstream AG and Others v. (No. 1) PK Airfinance SARL (PK)*, and (2) GE Capital Aviation Services Limited (GECAS) [2013].

7 *Pindell Limited and BBAM Aircraft Holdings 98 (Labuan) Limited v. AirAsia Berhad* [2010] EWCH 2516.

8 *Celestial Trading 71 Limited v. Paramount Airways Private Limited* [2010] EWHC 185 (Comm).

9 *ACG Acquisition XX LLC v. Olympic Airlines* (in special liquidation) [2012] EHWK 1070 (Comm).

10 *Global Knafaim Leasing Ltd & Anor v. The Civil Aviation Authority & Ors*, Court of Appeal – Administrative Court [2010] EWHC 1348 (Admin).

Shipping

Changes in regulation can affect a shipping company and its financiers by requiring additional capital expenditure to modify a ship to comply with new requirements (such as regulations relating to ballast water or sulphur emissions) or by restricting the economic usefulness or life of the ship (perhaps where modification is not economically or technically feasible), thus reducing its profitability and value.

Much shipping legislation in the United Kingdom derives from conventions and regulations issued by the International Maritime Organisation. However, the European Union also provides some additional regulation and legislation relating to the shipping industry. While the United Kingdom has voted to leave the European Union, the terms of its exit have not, at the time of writing, been agreed, and so it is conceivable that there may be some changes to domestic shipping legislation as a result of Brexit, but it is doubtful whether these would be significant or wide-ranging.

Rail

Railway policy is politically charged and constantly changing. There are renewed threats of renationalisation against a background of continued discussion about fundamental aspects of the industry, such as:

- a* the adequacy of the performance of the infrastructure (whether Network Rail should be broken into regional entities to create a more competitive environment; whether operators should be able to take over the infrastructure management);
- b* the appropriate approach to franchising (how long franchises should last for); or
- c* whether foreign state operators should be allowed to take on franchises and extract the profits (the German, Dutch and French state railways all operate franchises).

A government review of the UK rail industry (the Williams Rail Review) is ongoing, and could result in major changes to the industry.

In itself, Brexit is unlikely to drive change, but it might widen the opportunity for new industry structures to be created.

iii Trends and outlook

Aviation

The main manufacturers are forecasting a significant increase in the number of aircraft operated globally over the next 10 to 20 years. Much of the new fleet will be destined for operation in the Asia-Pacific region or Latin America, with the number of aircraft being operated in Europe remaining relatively stable.

As the financial crisis becomes more distant and banks find alternative sources of liquidity for their debt offerings, there has been a return of the commercial banks to the aircraft finance market.

As bank margins have increased, more airlines have been turning to the capital markets to finance aircraft. In particular, there has been more appetite for the Enhanced Equipment Trust Certificate, with airlines such as Air Canada, Emirates, Turkish Airlines, Norwegian and British Airways accessing the market.

Finally, the percentage of aircraft operated by airlines under operating leases continues to grow. There is a significant number of new entrants into the operating lease sector, often backed by private equity, and they too have their financing needs. There has been a significant increase in the number of operating lessors based in China.

Shipping

Resumption in trade growth should gradually ease the imbalance between supply and demand for ships. Shifts in oil prices affect demand for assets involved in offshore oil and gas and changes in trading patterns or regulatory changes may affect demand, positively or negatively, for certain other categories of ship.

As with other types of economic activity, there will be some shift of emphasis in global shipowning towards the Far East (for example, as Chinese shipping companies continue to grow their fleets) and other emerging markets, which international shipping banks and English-qualified shipping finance lawyers will be well placed to serve. There has been an increase in leasing transactions (mainly in the form of a sale and related 'leaseback' of one or more vessels) in China, Japan and Norway in recent years, a trend that is expected to continue.

The impact on the shipping industry of the United Kingdom's decision to leave the European Union remains to be seen. If trade to and from the United Kingdom is significantly affected by Brexit, then this could have implications for shipping. However, given the global nature of the industry, the Brexit vote may have little impact and may offer new opportunities to some sectors.

There will, however, always need to be ships, and finance for them. While it is likely that banks and export credit agencies will also continue to have the major role in ship financing, there is likely to be a growing role for debt and equity capital markets and other specialised forms of finance.

Rail

Investor interest in the United Kingdom passenger railway industry remains strong. Apart from the continuing need to replace old rolling stock there are continuing and developing opportunities coupled with new infrastructure and its associated need for rolling stock, arising from planned new large-scale rail developments (e.g. HS2), opportunities in the light rail sector and technological advances (e.g. hydrogen cell powered locomotives and improvements allowing more services on existing lines). This positive environment is supported by buoyant passenger numbers (despite a slowing of growth in this respect) and a government determination to create the best structures and operating environment for the railway. In particular, developments might be expected as a result of the opportunities afforded by the United Kingdom leaving the European Union and the ongoing government review of the industry. The major threat to the investment opportunities is that, should there be a change of government, the industry could take a radical turn towards becoming a nationalised industry again.

UNITED STATES

Norton Rose Fulbright (United States Practice)

I INTRODUCTION

The United States – and specifically New York – is a global financial centre and leading jurisdiction for vessel-financing transactions. Home to many large financial institutions and public exchanges, shipping companies have long sought financing in the United States. Furthermore, many international shipping companies, as well as major legal, financial and other service providers to such companies, are located in the United States. In addition, admiralty law is subject to US federal jurisdiction establishing consistent court precedent providing security for business practice.

Historically, the shipping industry's principal source of capital has been the domestic and international debt finance bank market. The shipping industry was affected by the worldwide economic downturn and financing has proven much more difficult to secure. The US vessel finance market has adapted to this changing landscape and has expanded sources of capital to include public capital market debt and equity offerings as well as the infusion of private equity (PE) investments. In the latter case, PE investors have learned the intricacies of the shipping markets and invested in a multitude of different projects.

Also, the surge in US crude production created strong demand for US trades. Future oil prices continue to dictate the direction of this trend.

II LEGISLATIVE FRAMEWORK

Domestic and international law and regulation

The financing of US-flagged vessels is regulated by national, state and local laws as applied through various administrative agencies. National legislation includes the Ship Mortgage Act, the Merchant Marine Act, the Maritime Security Act, the Oil Pollution Act (OPA), the Comprehensive Environmental Response, Compensation and Liability Act and the Coast Guard Authorization Acts. Administrative agencies include the United States Coast Guard (USCG), its sub-agency, the National Vessel Documentation Center (NVDC) and the Maritime Administration (MARAD).

Vessel documentation requirements

Section 27 of the Merchant Marine Act, also known as the Jones Act, provides for the registration and documentation of vessels under the US flag. The NVDC is authorised to document any vessel of at least 5 net tons not documented under the laws of a foreign country and wholly owned by an 'eligible owner'. An eligible owner, also known as a 'documentation citizen', must satisfy certain management-level criteria. For example, in the

case of a corporation, the chief financial officer (by whatever title) and chairman of the board of directors must be US citizens. All directors, except a minority of the quorum, must be US citizens.

A US-flagged vessel is eligible to receive one of three 'endorsements' – registry, fisheries and coastwise – each of which permits the vessel to engage in certain types of commercial activity. As part of its due diligence prior to financing the purchase of a US-flagged vessel, a financier should examine the relevant vessel's trade endorsement and confirm that the vessel is authorised to conduct the contemplated commercial activity. A registry endorsement entitles a vessel to engage in trade between a US port and a foreign port, and between two foreign ports. A coastwise (cabotage) endorsement entitles a vessel to engage in trade between two points in the United States to which the coastwise laws apply, either directly or via a foreign port. To be eligible for a coastwise endorsement, a vessel must be built in the United States and owned, operated and manned by US citizens. A corporation is only deemed a US citizen for coastwise trade purposes if at least 75 per cent of its equity interests are held by US citizens.

Debt financing

Since the 1996 amendments to the Ship Mortgage Act (eliminating the requirement of the 'Westhampton Trust'), there are no restrictions on the citizenship of mortgagees holding a mortgage on a US-flagged vessel. If a mortgage covers the entirety of a documented vessel, it will be characterised as a preferred ship mortgage, valid against the grantor, mortgagor or assignor, the heir or devisee of any such party, or any other party having actual notice of the mortgage. To be valid against third parties, it must be perfected by filing with the NVDC. This requires that the mortgage identify the vessel, state the name and address of each party, state the amount of the direct or contingent obligations, the interest of the grantor, the interest mortgaged and be signed and notarised. A foreign mortgage is deemed preferred in the United States if it was executed under the laws of a foreign country and has been registered at a foreign central office.

Lease financing

An entity that meets the documentation citizen requirements in relation to a registry endorsement is permitted to own a vessel with a coastwise endorsement if: (1) the entity is primarily engaged in leasing or other financing transactions; (2) the vessel is under demise charter for at least three years in duration to an entity qualified to engage in coastwise trade; and (3) the owner is independent from and not affiliated with any charterer or any person that has the right to direct vessel movement or its use. This 'foreign lessor exemption' was designed to permit passive foreign leasing companies to finance, under a lease structure, US vessels with a coastwise trade endorsement. In the event of a default, while lessors cannot operate a coastwise vessel directly, they may sell the vessel to a US citizen or a non-US citizen with MARAD approval or appoint a new lessee to charter the vessel (under a new lease or a lease assumption). A foreign lessor should be exempt from the strict environmental liability provisions of OPA 90 and CERLCA if they hold an 'indicia of ownership' primarily to protect a security interest, and do not exercise decision-making control over the vessel.

In the *Lykes Bros Steamship* case,¹ a bankruptcy court held that a vessel lease-financing transaction was a mere 'financing transaction' and not a 'true lease'. The court recharacterised the transaction and held that the demise charterer was the true owner, rendering the lessor an unsecured creditor. To protect against this risk of recharacterisation, lessors can require the demise charterer to execute and file a preferred ship mortgage (usually for the full value of the vessel) in favour of an affiliate of the lessor. Typically, the foreign lessor then purchases the vessel back from the demise charterer for a nominal sum before chartering back the vessel. This legal framework attempts to ensure that if the transaction is recharacterised as a loan, the preferred ship mortgage in favour of the bank's affiliate, which predates the transaction, operates to provide the bank with some degree of security over intervening creditors.

III FINANCIAL REGULATION

i Regulatory capital and liquidity

Banking organisations in the United States are subject to complex risk-based regulatory capital rules. Some banking organisations may use internal risk management models approved by the relevant regulator; others must use standardised rules set out in the regulations. Generally speaking, the more risk associated with a particular loan, the more capital that must be reserved against it on a bank's books. The risk associated with shipping has put capital constraints on ship lenders.

The United States has adopted the Basel III risk-based capital requirement regime. Each federal bank regulatory agency has promulgated the requisite risk-based capital requirements.² For example, under the standardised regulatory capital regulations, ordinarily, corporate loans are assigned a 100 per cent risk weight, which can be adjusted upwards by the applicable supervisory authority. In accordance with the applicable regulations, collateralisation of a loan may then mitigate the risk weight of a particular asset. Notwithstanding, the delivery of standard ship security (mortgage, assignments of earning and insurances, etc.), loans to finance ships are considered high-risk and impose significant capital reserve requirements on banks lending to this sector.

In addition to the risk-based capital requirements, banking organisations also need to comply with a leverage requirement, which is a ratio of its Tier 1 capital (e.g., common equity) to an aggregate of certain assets (e.g., on-balance sheet assets such as loans). Banking organisations also will be subject to certain short and long-term liquidity requirements. Requirements may vary depending upon the amount and nature of the banking organisation's assets and activities.

ii Supervisory regime

In the United States, there are several bank regulators. Bank holding companies are regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board). Banks can be chartered by either a US state regulator, such as the New York Department of Financial Services (a state-chartered banking organisation), or the United States Department of the Treasury (a national bank or federal savings association). Federal deposit insurance is provided by the Federal Deposit Insurance Corporation (FDIC). State-chartered banking

1 *In Re Lykes Bros Steamship Co Inc*, 216 BR 856 (MD Fla 1996).

2 See 12 CFR Parts 3, 217 and 324.

organisations also have a federal overlay of banking regulation and supervision, by either the Federal Reserve Board or the FDIC, depending upon whether the state-chartered banking organisation is a member bank of the Federal Reserve System. The applicable federal and state banking laws, including the capital regulations, are the primary banking legislation and regulation affecting the banks' ability to lend into the transport sector, but their applicability may be limited by more specific US transport-financing laws and regulations discussed elsewhere in this chapter.

IV SECURITY AND ENFORCEMENT

i Security documents

Lenders typically require a package of security documents, enforceable against the shipowner, or the ship itself, in the jurisdictions into which the ship calls. These include preferred ship mortgages, assignments of a vessel's earnings, insurances, charters and requisition compensation, share pledges by owner holding companies, undertakings by vessel managers, guarantees and assignments of deposit accounts.

Under US law, the most common form of US vessel security is the 'preferred ship mortgage' under the Commercial Instruments and Maritime Liens Act (CIMLA). To gain preferred status, a mortgage must meet several requirements, including being made in favour of a mortgagee that is either a United States state, the United States government, a federally insured depository institution, a citizen of the United States, a person qualifying as a citizen of the United States under Section 50501 of Title 46 of the United States Code, or a person otherwise approved by the Secretary of Transportation. A preferred ship mortgage is perfected by filing the mortgage with the central registry at the NVDC.

ii Enforcement, arrest and judicial sale

The primary mechanism for enforcement of a preferred ship mortgage on either a US or foreign-flagged ship in the United States is an *in rem* action under a federal court's admiralty jurisdiction. Such an action may be brought in any US district where the vessel is physically present. The court may appoint a receiver to operate the mortgaged vessel in global trade so the vessel may continue to earn revenue while maintaining *in rem* jurisdiction over the vessel, or, if the court finds that the lender's mortgage is valid and in default, the court may order that the vessel be arrested by the US Marshals Service and sold in a judicial sale. The US marshal for that judicial district will then serve the warrant and related documents to the vessel and effectuate the arrest. If the owner is unable to post a bond or other security for the mortgage claim, the vessel will remain in the custody of the court pending an interlocutory sale thereof. When a vessel is sold by order of a US district court in an *in rem* action, all claims against the vessel are terminated and subsequently attach to the proceeds of the sale.

Ranking of liens

Judicial sale does not guarantee the lender full repayment. The proceeds from a judicial sale are used to satisfy maritime liens in order of relative priority; for example, competing maritime liens are ranked according to class and top-ranked claims are paid out first, while among maritime liens of equal class, later liens have priority according to the 'inverse order' rule.

Preferred ship mortgages rank highly as maritime liens, taking priority over all claims (except the costs of administering the sale) that are not 'preferred maritime liens', consisting

of seaman's liens, salvage and general average liens, tort liens, and any other maritime liens arising before a preferred mortgage was filed. As between two mortgages, each is prioritised according to the 'first-in-time' filing rule, subject to the application of the 'voyage rule', which provides that two claims of the same class arising during the same voyage are paid *pro rata*. The date a mortgage is filed is the relevant date for the ranking analysis, not the date the funds are actually advanced, provided the mortgage covers the subsequently advanced debt. If a mortgage is amended to provide for an advancement of new funds not covered by the original agreement, then the new funds are likely to be treated as being covered by a separate, newly created mortgage.

A lender is not bound by the remedies afforded it by operation of US federal law. A lender can exercise private and extrajudicial remedies – such as taking possession of the vessel – if such remedies are permitted under the contract (mortgage or loan agreement) and under the laws of the state where the vessel is located. CIMLA expressly allows lenders to 'enforce [a] preferred mortgage lien or a claim for the outstanding indebtedness secured by the mortgaged vessel [. . .] by exercising any other remedy (including an extrajudicial remedy) against a documented vessel [or] a foreign vessel [. . .] for the amount of the outstanding indebtedness or any deficiency in full payment of that indebtedness', but only if the remedy is allowed under the law of the state where the vessel is docked. For example, in the *Dietrich v. Key Bank* case,³ the court held that a bank could repossess a vessel that was docked at a Florida harbour because the bank specifically contracted for such a self-help remedy and the right of repossession existed under Florida state law.

Repossession by a non-citizen

Complications can arise when a vessel with a coastwise endorsement is repossessed or purchased at a judicial sale by a non-citizen mortgagee. Such a right of purchase by a mortgagee is specifically provided for in 46 USC, Section 31,329, notwithstanding the strict regulation of the citizenship of entities that own and operate coastwise-qualified vessels under the Jones Act. If a coastwise-qualified vessel is repossessed or purchased by a non-US citizen mortgagee, the vessel may only be held temporarily for resale subject to emergency sale restrictions. It may not be 'operated, or caused to be operated, in commerce'.⁴ As long as it complies, the vessel should also not permanently lose its coastwise trading privilege, which it would if it were sold to a non-citizen.

V CURRENT DEVELOPMENTS

i Recent cases

The definition of which structures constitute 'vessels', thus capable of being the subject of preferred ship mortgages, was recently revised by the Supreme Court in the decision *Lozman v. City of Riviera Beach, Florida*.⁵ In that case, the Court considered whether a houseboat, permanently moored and without a propulsion mechanism, constituted a vessel subject to federal maritime law. The Court referenced the Rules Construction Act, which defines a vessel for purposes of the US maritime statutes as including 'every description of watercraft

3 *Dietrich v. Key Bank NA*, 72 F.3d 1509 (11th Cir 1996).

4 46 CFR § 221.19.

5 *Lozman v. City of Riviera Beach, Florida*, 133 S Ct 735 (2013).

or other artificial contrivance used, or capable of being used, as a means of transportation on water'. The Court further articulated that a floating structure is not a vessel 'unless a reasonable observer, looking to the [structure]'s characteristics and activities, would consider it designed to a practical degree for carrying people or things over water'. This has come to be known as the 'reasonable observer' test for determining vessel status. Under this test, 'not every floating structure is a 'vessel'', and the mere ability to relocate a structure over water does not automatically render it a vessel. Moreover, the subjective intent of the structure's owner is irrelevant – only the 'physical attributes and behaviour of the structure', which are 'objective manifestations' of the structure's 'purpose', affect vessel status. The decision has cast doubt over established principles of the United States Circuit Courts of Appeals, and created confusion regarding which vessels can be subject to preferred ship mortgages. The decision also creates the potential situation that, despite a structure's USCG status as a documented vessel, it may not constitute a vessel under the general maritime law as applied by federal courts.

The challenge of a public company satisfying coastwise citizenship requirements was highlighted in the USCG's recent investigation into the citizenship of Trico Marine Services Inc. In that case,⁶ a non-citizen shareholder of Trico alleged that, through its two vessel-owning subsidiaries, Trico had breached the 75 per cent US citizenship requirement of its vessels' coastwise endorsements. Trico contended that it was impossible to verify whether public shareholders were of US citizenship as certain shareholders are entitled to prohibit the disclosure of their identity under SEC regulations including the Exchange Act. In the alternative, Trico relied upon shareholder declarations obtained through the Depository Trust Company programme, which showed that no more than 25 per cent of shareholders were non-citizens. In making its decision, the Coast Guard dismissed both of Trico's defences as inadequate to establish compliance with the 75 per cent threshold. It held that if a publicly traded corporation sought the 'privilege of engaging in the coastwise trade', it must 'structure itself and its equity securities in such a way [. . .] by which it can satisfy its obligations under the Jones Act'. The Coast Guard fined Trico approximately US\$6 million and recommended that the NVDC invalidate each vessel's certificate of documentation. The decision arguably left publicly traded corporations with little guidance as to how to structure their operations to ensure compliance with coastwise requirements.

ii Developments in policy and legislation

The shipping industry is frequently subject to changing legislation that affects the profitability of vessels and the value of vessel security. For example, new environmental regulations and vessel security measures require shipowners to make additional capital expenditures to ensure compliance. It is important to note that these regulations are imposed by local, state, national and international authorities, and can be inconsistent.

While legislation is often proposed in the US Congress to repeal the restrictions on coastwise endorsements and to open the Jones Act trade market to foreign-flagged vessels, they have been defeated because of strong opposition from US shipyards, maritime unions

⁶ Memorandum from Timothy V Skuby, Acting Dir, Nat'l Vessel Documentation Ctr, US Coast Guard, to Kevin Cook, RADM, US Coast Guard, US Coast Guard 1, 20–21 (12 January 2011), www.uscg.mil/hq/cg5/nvdc/report/Trico.pdf.

and national defence interests. Notwithstanding, the US Department of Homeland Security has issued waivers permitting non-coastwise qualified ships to carry cargo in these areas to aid relief efforts following unprecedented hurricanes in the US Gulf and Puerto Rico.

There have also been recent concerns about a global trade war that could affect the US shipbuilding industry through legislation. In late 2015, Congress was considering legislation that would require all US-produced LNG to be exported on US-built-and-flagged vessels. However, the proposal failed in order to protect the competitive advantage of US energy exports.

iii Trends and outlook for the future

New York will continue to be a key jurisdiction in vessel-financing transactions. While traditional sources of financing have constricted in the United States and elsewhere, the US market has adapted and responded to meet the financing demands of shipping companies. With the increase investment in shipping by US private equity investors, US-based lending through US lenders and US branches of foreign lenders has also increased. These newly created US-based companies backed by US private equity interest will continue to require US law transactions.

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Dr Fenech's professional experience and expertise as a Malta-based lawyer span a number of areas of law, but he has concentrated particularly on the fields of maritime and aviation law, corporate commercial law, various aspects of financial services law and the developing field of the law of fiduciary obligations, including the law of trusts and foundations.

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Goemans, De Scheemaecker & De Wit

Benoît Goemans (Cand and Lic Law, Louvain; Dipl maritime law, Antwerp; LL.M. in Admiralty Tulane) was called at the bar in 1987 and clerked with O'Neil Eichin (New Orleans), then practiced in two major law firms in Antwerp until he co-founded Goemans, De Scheemaecker in 2006.

He was Professor of Maritime Law at the University of Louvain from 1994 up to 2008 and from 1998 up to 2008 Professor of Marine and Transport Insurance at the Hasselt University and Professor of Maritime Law at the Transport postgraduate degree of the University of Brussels (1997–2008) and guest speaker at the University of Antwerp (1997–present).

His practice is oriented on trade, finance and transport, including recoveries. He was involved in the major collision cases, insolvency cases and almost all the judicial sales of ships (the latter for the mortgagee). He drafts financial instruments and attests the validity thereof.

He also handles general commercial law matters (contract drafting and litigation in relation to the performance of contracts, director's liability, etc.).

The clients Benoît Goemans works for range from midsize traders to the world's largest multinationals in the trade, finance, leasing, shipping and insurance industry. An important part of Benoît's assignments often originates from large law firms, both foreign and domestic, who have been relying for decades on his expertise and dedication.

He is or was a board member of various organisations (Foundation Albert Lilar, Comité Maritime International, Charitable Trust of the CMI, Belgian Maritime Law Association (Vice-President)), editor of law reviews (*Antwerp Maritime Law Review* and *European Journal of Commercial Contract Law*) and member of the CMI's IWG on Judicial Sale of Ships. He was a speaker at many occasions and published mostly on transport law related subjects. He is the author of Belgium's standard book on maritime liens and mortgages ('Privilèges et hypothèques maritimes et fluviaux', Répertoire Notarial, Larcier, Bruxelles, 2009).

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Kenneth Gray is a consultant in our London banking department and has over 30 years' experience of advising on banking and security law in London and Paris. He joined Norton Rose Fulbright in 1986, founded the Paris office in 1990 and became a partner in 1993. He has been a consultant to the practice since 2006.

During his career, Mr Gray has focused primarily on aircraft and other asset finance. Many of the transactions on which he has worked have been selected as 'deal of the year' by trade periodicals. Since becoming a consultant at the practice, Mr Gray's activities have focused on advising clients on strategic issues such as the implementation of the Basel Accords and the Capital Requirements Regulation, the ratification of the Cape Town Convention by the United Kingdom and the consequences of Brexit.

In parallel to his consultancy, Mr Gray has developed a successful career training banks and other companies on diverse issues such as aviation finance, asset finance, structured finance and loan and lease documentation.

Mr Gray is a member of the executive committee of the Legal Advisory Panel to the Aviation Working Group and the head of the UK National Contact Group for the Cape Town Convention.

RICHARD HOWLEY

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Richard Howley is a banking lawyer based in London who is experienced in international ship finance, with a particular focus on financing LNG carriers. He has a broad range of experience in bilateral and syndicated debt facilities and structured financings, including the project and lease financing of LNG carriers and the project financing of semi-submersible drilling rigs, FPSOs and other floating production units, and the negotiation of shipbuilding and other transport contracts, particularly in connection with shipowners tendering for LNG projects. Mr Howley has been involved with the financing of both second-hand and new-build vessels, acting for shipowners, banks and lessors worldwide. He has also acted for international banks and finance lessors in relation to the debt financing and lease restructuring of semi-submersible drilling rigs, drillships and FPSOs.

RENATA IEZZI

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Renata is a Brazilian lawyer based in São Paulo. She concentrates on commercial and civil law litigation involving foreign entities and international trading agreements, aircraft financing and leasing, civil liability in air transportation and shipping, damages of varied types, judicial recuperation and bankruptcy. Her overall professional experience also includes consulting for foreign entities investing in Brazil, and contracts in general. She obtained her Bachelor of Laws degree (LLB) at the University of São Paulo, Brazil (LLB, 1993). Renata has been a member of the Brazilian Association for General Aviation (ABAG) since 2013.

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Tom Johnson is global head of Norton Rose Fulbright's rail group and is a banking lawyer based in London. He specialises in rail-financing transactions and has extensive experience advising on a wide variety of rail-related matters, both in the United Kingdom and internationally.

Mr Johnson is 'a lawyer of excellent ability' and a 'key man who does a wide spread of UK and international work', according to legal directory *Chambers Global 2019*. *Chambers UK 2019* describes Tom as 'extremely knowledgeable' and 'very thorough and someone who focuses on the details and the technical aspects', and 'one of the most respected practitioners in the field of rail finance'.

His clients include government bodies and regulators, manufacturers, ROSCOs, financiers, operators and owning groups. Tom has advised on all aspects of the rail industry, with particular experience in rolling stock procurement, leasing, maintenance, modifications, franchise bids and handovers, track access and rolling stock financing.

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Zhu Jun is a partner in the banking and finance team of Han Kun Law Offices. His practice areas include asset finance, project finance, cross-border and domestic lending transactions, establishment of financial institutions and regulation compliance, and other banking and finance transactions.

CARLOS LÓPEZ-QUIROGA

Uría Menéndez

Carlos López-Quiroga has been a partner in the Madrid office of Uría Menéndez since 2002.

He specialises in maritime and transport law, asset finance transactions in the transport sector, and M&A. He advises on all kinds of complex structures for the acquisition, leasing, construction, insurance and securitisation of assets.

Carlos has been recommended for shipping finance by *Chambers Europe* (2008–2018) and *Best Lawyers in Spain* (2013–2018).

ANDRÉ ALMEIDA MARTINS

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André Almeida Martins joined Uría Menéndez – Proença de Carvalho in September 2007.

His professional practice is focused on civil, corporate, commercial – including maritime issues – and insolvency litigation and white-collar crime at every level of the Portuguese court system. He advises both national and foreign companies.

As of 2016, André is the managing associate of the litigation practice area of the Porto office.

He is also a lecturer and a researcher in the Faculty of Law of the Portuguese Catholic University.

ALEXANDER MEDNIKOV

Jurinflot International Law Office

Alexander Mednikov is a managing partner of Jurinflot. Having graduated with honours from the law faculty of the Russian People's Friendship University (Moscow) in 1998, he joined the firm full time in 1999, was admitted to the Bar in 2002 and became a partner in 2003. Alexander advises clients primarily in issues of ship finance, international trade and M&A.

JUSTEIN MOEN

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Jostein Moen is a partner and head of Kvale's corporate M&A department. He primarily works with transactions, but assists also in disputes within shipping-related matters.

He has extensive experience within M&A, as well as other equity and financing transactions, including bond issues. Within shipping and offshore, he has wide experience related to sale and purchase of vessels and units, chartering, sale and leaseback transactions and ship finance. He works also with restructuring of businesses.

NORTON ROSE FULBRIGHT (MARSHALL ISLANDS PRACTICE)

Norton Rose Fulbright

Norton Rose Fulbright has one of the world's largest Marshall Islands (RMI) practices and is able to serve clients operating across all time zones, particularly from our offices in New York and Hong Kong. Our lawyers have advised on some of the most complex and sophisticated RMI transactions in the market, including acquisitions, financings, registrations, enforcement, joint ventures and offerings, as well as on the formation, restructuring and mergers of offshore and domestic entities across various business sectors. Our RMI-qualified lawyers represent international financial institutions, funds, listed companies and vessel owners.

NORTON ROSE FULBRIGHT (US PRACTICE)

Norton Rose Fulbright

Norton Rose Fulbright's US shipping practice is one of the few major corporate practices with significant skill in shipping matters in the key markets of New York and Houston, backed by a full-service practice throughout the US. Our lawyers advise on the full range of ship finance transactions, including capital markets, structured finance, restructuring and bankruptcy.

In addition to representing US and international banks active in international shipping transactions, we increasingly represent non-traditional sources of ship financing, including funds, governmental finance support entities and issuers in capital markets transactions. We are also closely involved in the offshore oil and gas industry in the Gulf of Mexico and Latin America, supporting our financial institutions, shipowner and energy company clients.

CHRISTIAN B ØSTLIE

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Christian B Østlie has extensive experience advising on all aspects of corporate law, with a main focus on M&A/transactions. His practice also includes banking and finance.

His experience in banking and finance includes contractual negotiations, financing and accompanying loan and security documentation to both Norwegian and foreign clients. He has represented both finance institutions and borrowers.

Christian also works with regulatory conditions and gives broad legal assistance to financial institutions, including publicly listed financial corporations.

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Carlos is a Brazilian lawyer currently based in London. He obtained a law degree at the Pontifical Catholic University of São Paulo Law School, Brazil (LLB, 1986), and a Master of Laws at Georgetown University Law Center, Washington, DC (LLM, 1989), with a specialisation in international trade and finance. Carlos qualified as a lawyer in Brazil in 1987, and as a lawyer in New York, in the United States, in 1989. He specialises in ship finance.

RYUICHI SAKAMOTO

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Ryuichi Sakamoto is an associate at Nishimura & Asahi with over seven years of experience in advising on asset finance and other structured finance transactions, as well as banking regulations.

Mr Sakamoto regularly advises Japanese banks, leasing companies, and other financial institutions as well as Japanese airlines and shipping companies on a large number of asset finance transactions in relation to aircraft, vessels, rolling stocks, marine containers and other assets. He also has experience in advising foreign financial institutions on Japanese financial regulations.

Mr Sakamoto obtained his bachelor of law degree (LLB) from the University of Tokyo in 2008 and his Juris Doctor degree (JD) from Hitotsubashi University School of Law in 2010. He is admitted to practice in Japan.

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Mr Shibukawa is recognised as an industry expert in many legal directories, including *Who's Who Legal (Aviation/Shipping/Banking)* and *IFLR 1000 (Structured Finance/Banking)*.

Mr Shibukawa obtained his bachelor of law degree (LLB) from the University of Tokyo in 1998 and his master of law degree (LLM) from New York University School of Law in 2006. He is admitted to practice in both Japan and New York.

WANG SHU

Han Kun Law Offices

Wang Shu started as a legal professional in 2000 and is now the head of Han Kun's banking and finance team. Her practice areas include general banking, asset finance, project finance, aviation and shipping finance. She is listed in the top tier for both Banking and Finance and Aviation Finance in China by Chambers Asia-Pacific and Global, IFLR1000, Asia Law and Legal 500.

LUCIA STUHLREIER

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Lucia Stuhldreier is a partner and a member of McMillan LLP's Transportation Group. Lucia advises and represents rail shippers in negotiations of rail transportation agreements, including rate and service matters, and agreements for the construction, acquisition and shared use of rail trackage. She has extensive experience in rail regulatory proceedings before the Canadian Transportation Agency and arbitrations relating to rail freight rates, service issues, interswitching and railway line discontinuance, as well as related judicial review and appellate proceedings. Lucia also advises clients on rail transportation policy and regulatory matters relating to aviation and truck transportation.

SHARDUL J THACKER

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Shardul Thacker, partner, heads the firm's admiralty, shipping, and oil and gas practice groups. He co-heads the banking and insurance practice groups. He advises multinational and Indian companies across industries: banking, insurance, shipping, steel, subsea engineering and marine services, offshore construction, infrastructure (LNG ports, oil and gas), tooling and bearings, transport, trade and logistics. He advises on ship and structured finance, including regulatory issues – flagging, cabotage, tonnage tax, while investing in shipping ventures, LNG/FSRU projects, etc – as well as reviewing bid documents and assessing risk areas. In commercial practice he handles contracts of sale and purchase of goods and services, long-term take or pay contracts, supply chain contracts of raw material and products, among others.

Lloyd's List ranked him in their 'Top 10 Lawyers', 'HIGHLY regarded for his work in the LNG sector, particularly for interesting and highly geared finance deals in relation to

infrastructure projects, energy, ports & ships'. He is also ranked in Band 1 by *Chambers* for several years in shipping and maritime practice.

He is the India correspondent for *Lloyd's Maritime and Commercial Law Quarterly* and vice president of the Indian Maritime Law Association, affiliated to the CMI.

HARRY THEOCHARI

Norton Rose Fulbright

Harry Theochari is a shipping and asset finance lawyer based in London, where he is the firm's global head of transport. He is experienced in international shipping finance and has wide experience of syndicated facilities, OECD and export credit-based financings, structured financings, private equity and capital market transactions.

Mr Theochari is highly regarded in international shipping finance and has been involved in some of the most innovative ship finance structures of recent years, for both new-building and second-hand vessels, oil rigs, platforms and other floating structures all over the world.

He has been named by *Lloyd's List* as the most influential shipping lawyer in the world and by *Tanker Shipping and Trade* as one of the most influential people in the tanker industry. Mr Theochari is cited by *Chambers Global* (2019) as a leading individual for asset finance and for shipping finance. *Chambers UK* (2019), describes him as having 'immeasurable experience, especially in complex deals'.

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