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Loan Agreement And Basic Security Package

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INTRODUCTION

The Ship Finance Market

The shipping market is multi-faceted, considering the many areas of work that are involved, which range from a simple tramping operation, through sophisticated joint-ventures and pooling systems, to complex financial arrangements. It is an international business where ships are considered to be mobile assets, capable of being traded effectively anywhere in the world. Vessel purchases require the commitment of large sums of money and lenders are often required to make quick decisions to match the market opportunities. As a result of this, ship finance requires specialist knowledge in articulating the risks attached and a thorough knowledge of the industry.

The shipping industry is also characterised by heavy capital investment and unlike most other activities, it usually carries a minor inventory position. Ships are dependent upon their continued operation to cover running expenses, repairs, debt service and revenues tend to be volatile. Depression in the shipping markets results in financiers and shipowners devoting an excessive amount of time on workout situations, rather than devoting the time to the generation of profitable and well structured transactions.

Types of Finance Available

Shipowners may seek the finance of ships with equity or with debt. The former is appropriate for shipowners who seek investors who will take a stake in the company, sharing the risks and receiving the rewards. In the latter, the shipowner retains full ownership of the business and is a flexible way of financing a shipping company.

The most common form of financing ships is the term loan. The five key aspects of a shipping loan are the tenor (i.e. the period of the loan); interest rate; fees (the charges for arranging and administering the loan); collateral (the assets or funds to which the bank has legal access if the borrower defaults); and the covenants (the conditions imposed by the lender setting out what the borrower must satisfy and the rights of the lender in the event of the borrower's default)

Mezzanine finance

Mezzanine capital is the subordinated layer of capital between shareholder's funds and senior debt. For the normal shipping transaction, the amount of equity contribution is derived from the amount of debt obtainable and, where there is a shortfall, the mezzanine provider has a role to perform. By its very nature, the mezzanine finance position is subordinated to the primary lender in all respects, usually characterised by a second mortgage and assignments. However, central to the facility would be the existence of a co-ordination agreement between the first and second

mortgage lenders, enabling the mezzanine provider to repay the primary lender and take over these rights in the facility.

There is no hard and fast mechanism by which a mezzanine loan can be structured. In order to overcome any difficulties that may arise in the course of a mezzanine assisted transaction, the mezzanine lender is required, generally, to have a long term view of both the industry and the shipowner and should not be bound by overwhelming regulatory and industrial shackles. In most instances, the mezzanine providers do not have a large capital base from which to work and must work diligently to preserve their projected higher returns from those transactions in which they are involved.

The mezzanine provider should have the ability to exit from the transaction as quickly as possible in order to minimize risk on the transaction and also to keep scarce capital resources profitably working for the shareholders.

Those who wish to benefit from a mezzanine finance are many and varied, ranging from the small but stable shipowner wishing to expand his fleet through the medium sized shipowner wishing to replace older tonnage to the corporate entity. The latter may not wish to show a major shipping related liability on its balance sheet and needs a genuine equity partner involvement to remove such identity. Such finance may even be required by a strong and reputable shipowner desirous to share the risks involved in a shipping investment with a partner who is not a competitor.

Bridging finance

A shipowner may be experiencing a temporary cash shortage and requires finance to take advantage of an opportunity in a favourable market. Bridging finance is conducted on an ad hoc basis.

Traditionally, a full security package is taken with the proviso that at the end of the agreed period of finance, the lender has the option to sell the vessel or continue the loan. The loan carries an interest rate with high margins, with perhaps peripheral fees accruing if the lender were to assume the role of seeking replacement finance. In the latter situation, it is possible for a bridge loan provider to dilute its loan and assume a mezzanine role for a lesser amount.

Syndicated loans

These are defined as a number of banks, combined together under a lead bank, to provide medium or long term loans running into hundreds of millions of dollars. Each bank contributes part of the loan or facility and hence, each bank can avoid too large a commitment to any one customer. The principal advantage to the borrower is that he is able to support any large investment programme or broaden its borrowing base through this form of finance. It is quite common to see a syndication as a combination of many facilities, often incorporating a term loan or a bridge financing.

Syndicated lending enables the lead bank to act as an intermediary, standing between the borrower and the participating banks. The lead bank is responsible for negotiating the terms and conditions of the facility with the borrower and frequently acts as the transaction's underwriter prior to the formation of a syndicate.

In reviewing the financing proposal, the prospective syndicate members will conduct their own financial analysis and assume full responsibility for their own credit judgement. During this period, these prospective syndicate members will indicate the pricing levels that they will accept for the transaction and will comment on preferred terms and structure to be incorporated in the final documentation.

Syndicate banks receive two distinct advantages. Firstly, they have the ability to participate in credits to which they would otherwise not have access to and secondly, they have the ability to diversify into different fields of activity.

After the lead bank completes the documentation of the facility and the banks have advanced proceeds to the borrower, the lead bank remains the main contact between the borrower and the syndicate member banks. In a syndicated credit, funds flow through the lead bank; on drawdown from the participant banks, and on repayment, to the participant banks.

THE LOAN AGREEMENT – THE BASIC PACKAGE

Commitment Letter

Preceding the loan agreement is the commitment letter, which is an efficient negotiating process between the lender and the borrower. The commitment letter usually states the lender's intention to offer a finance facility to a borrower following certain qualifications. A good commitment letter sets forth all the essential terms and conditions that will ultimately be in the loan agreement. It need not contain all the terms and conditions that will be in the loan agreement but it should cover all the major financial terms, and all conditions and covenants that are believed to be critical to the success of the transaction, or in any significant way controversial. Although the commitment letter is a conditional document in the sense that it is binding only upon completion of additional documents, it is nevertheless legally binding. Once the commitment letter is accepted by the borrower and returned to the lender, the parties to the transaction will appoint lawyers to represent them in the forthcoming negotiations.

The loan agreement itself exhibits the final outcome of a negotiation between the lender and the borrower. It is generally an expansion of the commitment letter and its structure will follow the specific points contained in the commitment letter and elaborate where necessary on the mechanics of the day to day process of operating the facility. It is difficult to generalise too much on the contents of the loan agreement but there are certain conventions which are usually included in the standard agreement.

Consideration Clause

To begin with, most loan agreements include at the beginning a preamble setting forth the interests of the various parties and their reasons for entering into the transactions. This is the part of the agreement that establishes the 'consideration' by establishing the fact that a mutual benefit exists between the parties as the bedrock of the contract. This 'consideration' is an important element in a contractual relationship and is a necessary procedure for the enforceability of the contract under Singapore law. Hence, it is worth taking this part of the agreement seriously.

For a fresh loan, the consideration for the mortgage is usually very clear. If the mortgage is given in respect of a restructured loan, the consideration clause should be carefully drafted because in such cases, the loans would already have been drawn down. Consideration would take the form of forbearance to sue or refraining from enforcing the loan.

Definition Clause

After the preamble, there is usually a list of definitions of terms that will be used throughout the document. This is to assist the reader of any uncertainty or misinterpretation of the meaning and operation of certain clauses of the agreement.

Clause Dealing with Functional Points

Moving on, the typical loan agreement will also include a section detailing the functional points. This specifies in detail the following:

- the necessary drawdown notices;
- the calculation of interest;
- the basis on which interest is worked;
- the calculation of fees; and
- an amortisation schedule and dates or the timing of payments of principal and interest.

Furthermore, there will be the inclusion of mechanisms to show how interest calculations will be changed after an event of default.

Conditions Precedent

Next usually comes a detailed listing of the security for the facility, and from there, a section outlining the 'conditions precedent'. The latter specifies what must happen, and what additional documents must be executed before drawdown will be permitted. This section provides a good checklist of the items that need to be addressed before the lender is prepared to advance any money or assume risk. The lender will usually require evidence of good title and registration of the security vessel, classification certificate of the vessel, appropriate insurance documentation, and that the borrower is a corporation in good standing and has taken all necessary steps internally to legally authorize the transaction.

Priority of Moneys Paid into Borrower's Bank Accounts

Most loan agreements include a section pertaining to the borrower's bank accounts and this section will often come shortly after the conditions precedent. This section specifies the order of priority in which moneys received into that account will be applied. Here, the wording refers to the assignment of earnings and, in the instance of a retention accounts forming part of the finance structure, language will be inserted in the framework of the documentation to encompass this point. In terms of ranking, the priority of payments received by the borrower is usually in the following order. First, all cost and expenses incurred under the security documents, secondly, any accrued interest outstanding, thirdly, principal payments and lastly, the balance is free to be given to any legitimate claimants.

Representations and Warranties

Next, there would be a section labelled 'Representations and Warranties'. This section has a direct relationship to conditions precedent and refers to these as assumptions on which the finance is advanced. In other words, this section carries the supposition that lenders would not pursue the business if the representations and warranties are found to be deficient in any way. For example, the borrower must represent that it is duly incorporated, with full power to carry on the business contemplated; that it is the legal owner of the vessel; that the vessel has a clean title, apart from mortgages securing the financing of the vessel.

Similarly, the borrower must represent that all consents and authorisations from the relevant governmental and agencies necessary to make the security documents enforceable have been obtained; that it is not in default, actual or imminent, under any other agreement or subject to any significant litigation. Further assurances are given to the effect that all the information proffered is accurate and no material adverse change has occurred since the submission of that information.

In relation to financing the construction of a new ship where the borrower is the shipbuilder, the loan agreement may require the borrower / shipbuilder to warrant that the shipbuilding contract is legal, valid and binding.

Essentially, the representations and warranties are a declaration from the borrower that all measures and conditions are current and will continue during the period of the facility. This section can be of some length, depending on the nature and complexity of the transaction but, nevertheless, important to the lender in establishing the right to set aside the agreement in the event of a dispute.

Covenants

The next major issue to be addressed is that of covenants. More usually, they are divided into positive and negative covenants. These state the actions that the borrower should take and those it should not take. Typical positive covenants would include the responsibility of the borrower to carry out its business in a professional and efficient manner; be lawful in the conduct of its business; comply with the terms and conditions of its financial obligations; provide all necessary information as required by the lender and promptly to disclose to the lender any imminent default.

The borrower may also covenant to perform all it obligations under the charter, charter and lease assignments, and mortgage.

Typical negative covenants include the borrower's promise not to allow its assets to be encumbered with liens, or to take action within an agreed period of time to cause any such liens to be lifted; not to borrow additional monies except on a subordinated basis; not to make loans or advances to third parties; not to guarantee obligations incurred by third parties and not to permit any change of ownership of the vessel.

The list of typical covenants must of course be tailored to the requirements of each specific situation and may be conditioned by the perception, or nature, of the risks involved and the wish on the lender's part to restrict the borrower's activities. They are intended to clearly establish the basis upon which business will be conducted. They do not, however, give the lender any rights to a course of action. The basis for a course of action is set by specifying events of default which are usually the subject of the next section of the loan agreement.

Events of Default

The 'Events of Default' section brings together all those areas where the borrower has failed to comply with the provisions of the foregoing clauses and term them a default under the loan agreement. Failure to observe the terms under the representations and warranties and covenants sections will normally represent defaults under the loan agreement. In addition, other main areas constituting defaults consist of the following: non-payment of debt; the onset of bankruptcy or receivership of the borrower; invalidity of the security documents and the default of any other debt within the borrower's group of companies.

In most well drafted loan agreements, the events of default have a 'cure period' which is the time for the default to be repaired and the facility to be restored to normal. In the event that the default is not resolved at the expiry of this period, the lender is within his rights to proceed against the borrower. The remedies available to the lender will have to be specified. The principal remedy is to declare the indebtedness immediately due and payable, and to foreclose on the vessel.

Jurisdiction Clause

Finally, the loan agreement will have a jurisdiction clause subjecting all aspects of the facility to a system of law and a jurisdiction acceptable to the lender. This usually depends on the domicile of the lender who prefers a jurisdiction in which it has confidence of a favourable and equitable judgement. It is not unusual for the lender to choose a jurisdiction at which its head office is located. It should be noted that the law and jurisdiction pertaining to the security documentation is rather different to the rules that apply to the flag. The former usually refers to the law governing all the financing documentation except the mortgage document. In the event that there is a conflict, there should be a clause in the loan agreement giving precedence to one particular form of law to aid due process and the place where it should be enforced.

There should also be a clause appointing an agent for service of process. When the borrower and lender are not located conveniently to each other, it is common practice to require the borrower to

appoint an agent in the lender's jurisdiction upon whom notices can be served with the same force and effect as if they have been served directly upon the borrower.

Execution Under Seal

It is correct that execution of a document under seal may not have the same effect in some other jurisdictions (eg Panama) as it would have in Singapore. There is no downside, however, in executing the document under seal.

Enforcement of the mortgage is usually not at the port of registration. Enforcement takes place where the vessel trades. In the countries where enforcement takes place, a document under seal may well have the desired effect. As such, it is always desirable to execute the documents under seal.

THE BASIC SECURITY PACKAGE

Mortgage

Overview

One vital aspect of ship financing is the security or collateral to be provided to the lender by the borrower in order that the former may be satisfied that it will be able to recover the sum lent.

The basic security is a mortgage of the ship by the borrower to the lender. It is normally the first item that a lender looks to in securing his loan. The prime purpose of a mortgage is to preserve the rights of the lender in the event of the vessel requiring to be sold in satisfaction of the outstanding loan.

Creation and registration requirements

The mortgage is created by contract and differs in form and content around the world. Mortgage of a Singapore registered vessel has to be registered under the Merchant Shipping Act, Chapter 179 ('Merchant Shipping Act') in Singapore in order to create a legal and statutory mortgage.

In Singapore, the mortgage document follows the form as provided in the Forms 4, 4A, 4B and 4C of the Merchant Shipping (Registration of Ships) Regulations, Chapter 179 Regulation 7 ('Merchant Shipping (Registration of Ships) Regulations'). The detailed terms are set out in a separate deed of covenants.

Deed of covenants

The structure of the deed of covenants includes a definitions section, like the loan agreement. In another section, the deed outlines the amount and category of insurance cover required whilst the mortgage is in operation. Further covenants ensure that the owner of the vessel complies with the terms and conditions of the various forms of insurance cover. This relates to the trading activities

of the vessel which may render the insurance cover inadequate or cancelled with the underwriters without the lender's prior consultation.

There may also be a term that the vessel is not to be employed in any illegal activity or trade. This is because in the event of this occurring, the owner and the lender run the risk of the vessel being impounded or confiscated. In these circumstances, the lender would not be able to look to insurance cover for recompense. Additional covenants may also ensure that the owner pays all costs and expenses relating to the daily operations of the vessel such as port dues. Failure of the owner to adhere to this may place the lender in the position of ranking behind the claimant of these costs and expenses in terms of priority.

It is a further requirement that the owner keep a certified record of the mortgage on board the ship and display a notice of the mortgage to evidence the claim of the mortgagee.

There would also be another section detailing the manner in which the vessel is to be maintained. They require the vessel to comply with a number of conditions, mainly those concerning the maintenance of the vessel with the highest classification with a recognized society; keeping the vessel well maintained and in good repair; maintaining the registration of the vessel under a jurisdiction acceptable to the lender and compliance with the conditions imposed under the flag of registry. Further covenants ensure that the lender is informed of all relevant information pertaining to the vessel's operation and maintenance; is given the right to inspect the vessel at any time and that any amounts advanced by the lender on behalf of the owner are to be reimbursed.

There would also be a section relating to the events of default. It is usual for this to be cross-referenced to those events of default set out in the loan agreement. Following this is the remedies available to mortgagee which generally accommodates the mortgagee taking possession of the ship and confers on him the power to sell the vessel. In Singapore, the mortgagee is conferred a power of sale under section 30(1) of the Merchant Shipping Act. More importantly, it should confer on the lender the right to stand in the shoes of the owner by assuming the full day to day management; taking over the insurance, maintenance and employment of the vessel; negotiating with other parties to settle payments and discharging of any outstanding claims.

Finally, the question of the application of funds is given consideration. This takes into account any proceeds received by the owner, specifically those relating to the sale of the vessel. In order of preference, the sale proceeds are first applied against any costs and expenses incurred by the lender on behalf of the owner; secondly, all outstanding interests is paid; thirdly, outstanding principal is extinguished and lastly, the balance is to the returned to the owner or any other claimant, as directed by the court.

Assignments

Assignment of earnings

The repayment of any financing obligation in shipping finance is principally through the earnings of the vessel. As such, lenders view the assignment of earnings as an integral part of the security

package. This usually includes a security interest in all or part of the earnings which fall into two categories. The lender will request a general assignment, covering all the revenue by the company and a specific assignment on any particular agreed income flow like a medium charter.

Lenders generally insist that all revenues generated by the vessel are paid directly to the bank. This operating account is pledged to the lender. This is in order for the lender to check that the vessel is performing according to the predicted cash flow and that all payments are received on timely basis. The operating account also enables the lender to track the expenses of the ship and gauge the efficiency of the running costs.

Notice to charterers

In relation to documentation, the central issue is that the owner is required to give notice to all the charterers with whom it conducts business, of the assignment of the charter earnings to the lender. This is done by way of a covenant inserted in the documentation and requires that all the charter hire is paid into an account designated at the lender's request. For a further discussion on the legal issues relating to assignment, please see the paper on 'Risk Management'.

Assignment of insurances

It is not unknown for a shippowner to incur risks in the day to day operation which may give rise to the vessel being inhibited from trading. As a consequence, the lender obtains and protects its interest in the proceeds from an insurance policy by way of a legal assignment. The assignment is normally contained in a separate document and lays down certain conditions necessary for the owner to observe in the conduct of his operations.

The appropriate assignment of insurance documentation will contain specific language detailing the scope of the insurances and where they are to be paid, taking into account amounts which can go directly to the borrower. Moreover, the assignment will set out the notices required by the lender in the event of non-payment or cancellation of the insurance policies. The purpose of this is to provide the lender with the opportunity to redress the situation and to take the necessary steps in protecting its interest in any secured vessels.

Guarantees

Nature of a guarantee

A guarantee is a collateral security involving three parties i.e. the guarantor, borrower and the lender, in which the guarantor agrees to be liable for the debts of the borrower. The mechanics of taking a legal guarantee are very simple. When a party offers itself as a guarantor, it signs a guarantee form and steps will be taken by the lender to verify the financial standing of the guarantor. On satisfaction of the guarantor's financial standing, the lender will proceed with the advance.

Formalities that must be complied with

A guarantee must be evidenced in writing and signed by the guarantor. This requirement can be found in section 6A(b) of the Civil Law Act, Chapter 43. Failure to satisfy this requirement renders the guarantee unenforceable. In a properly documented financing transaction, this requirement will inevitably be met.

Joint / several guarantees

Guarantees can be joint, several or both. Joint guarantees are usually offered in relation to the amount of commitment given by individual parties to the transaction. That is, they will only guarantee the proportion of their commitment.

On the other hand, a several guarantee provides the lender with an option to pursue any one of the guarantors for the total debt outstanding. As a rule, lenders prefer to take joint and several guarantees thus preserving al the options available to them in the event of the need to call other forms of support.

Ambit of a guarantee

The guarantee agreement will contain, among other points, the amount to be guaranteed which includes the full obligations of the borrower and any accrued interest or may be limited to a certain amount. In order to maintain the value of the guarantee, the lender may introduce covenants and provisions specific to the structure of the deal. Much is left to the negotiations between the parties.

Who should give the guarantee

The identity of the guarantor depends on the circumstances of each case, but would generally be a creditworthy person or corporation who can answer for the debts of the shipowner.

Corporate guarantees

In the case of a one-ship company which is the subsidiary of a substantial holding company, the guarantor could be the parent company. If the parent company has little or no assets, the guarantee could come from another related company with assets. The lender may want to introduce a covenant structure to regulate the borrowing behaviour of the members of the group to prevent them from incurring debts which will limit the value of the guarantee.

Personal guarantees

These are usually required where the ultimate borrower is not publicly owned or substantial in any other way. A personal guarantee can thus be taken from individual(s) with substantial interests in the shipowning company.

Many shipowners have a wide variety of personal assets, many of which are disguised. The guarantee will establish a link between the principal and his other interests, and the main purpose of such a guarantee is to ensure that the owner is personally committed to the transaction and that the lender has some control over the future ownership of the company.

RISK MANAGEMENT

National, Offshore And Open Registers

The shipowner may choose to register his ship in the country of his nationality. In Singapore, certain conditions have to be met in order for a vessel to be registered in the Singapore registry. These conditions are laid out in Part I of the Merchant Shipping (Registration of Ships) Regulations.

An open registry, commonly known as 'flags of convenience' allows the registration of foreign-owned and foreign-controlled vessels under conditions which, for whatever reasons, are convenient and opportune for the persons who are registering the vessels. Indeed, the fact of foreign control, if not foreign ownership, is a feature common to all flags of convenience.

Access to the registry is easy and registration may be registered at a consul's office abroad. A flag of convenience usually do not levy tax on the income of the ships and the only charges that are normally made are the registration fee and an annual fee based on the tonnage of the ship. The manning of ships by non-nationals is freely permitted and the country of registry has neither the power nor the administrative machinery effectively to impose any government or international regulations; nor has the country the wish or the power to control the companies themselves.

For the shipowner, an open registry is attractive in many ways. He may avoid tax that is imposed in the country in which he is established, and may take advantage of lower crewing costs since registration in an open registry means an unrestricted choice of crew in the international market.

The traditional maritime registries have recognised that any attempt to establish the open registries would be bound to fail. Hence, they established offshore registers. Offshore registers are designed to offer the many advantages of open registries, usually in the form of less stringent conditions concerning eligibility of ships, and ownership and crew nationality, but nonetheless retains a link between beneficial ownership or management under the national flag. Examples of offshore registries are the Isle of Man registry, the Norwegian International Ship Register (NIS) and the Madeira Ship Register (MAR).

The retention of the link with the national flag preserves the jurisdiction of the maritime power over vessels owned by its nationals which is important for regulatory, fiscal and strategic reasons. At the same time, it may ultimately obviate the need for the subsidies and other forms of financial assistance to shipping which have characterised maritime policy in the traditional maritime countries.

Considerations for Choice of Flag and the Impact of Flag on the Financier and the Security

A shipowner, when making the decision where to flag his vessel, must make the choice between registering his vessel in a country with which he has some genuine connection by way of national or economic ties and entering her in an open registry that will accept vessels regardless of the nationality of the persons beneficially interested in the vessel or the country from which the vessel is effectively controlled. The factors determining his choice will be economic and political.

The registration of a vessel under one of the traditional maritime countries, for example, the United States, Japan or the United Kingdom, generally implies subjecting the operation of the vessel to the fiscal regime in force in the country, and this would mean having to pay tax for the operations of the ship. The countries which operate open registries levy no taxes on the profits arising from the operation of the vessels under their flags.

Typically, a vessel registered under an open registry is owned by the corporation specifically formed for that purpose and having no other asset than the vessel herself. In many cases, the share capital of the owning company will be represented by bearer shares which, because of their ease of transferability, render the identification of the shareholders effectively impossible. The company is thus rendered opaque as far as the underlying beneficial interests are concerned and this allows the owner to escape tax liabilities in the country of his establishment where taxation is required.

On the other hand, the traditional maritime countries have sought to soften the impact of their fiscal regimes on the shipping sector by offering owners a package of incentives, such as tax rebates or deferrals and investment grants.

The freedom to avoid the high labour costs prevailing in the traditional maritime countries also provides a great stimulus for a shipowner to register his vessel under an open registry. Registration of a vessel in a traditional maritime country generally restricts the owner to employing crew members who are nationals of the country concerned and involves negotiations with local trade unions on rates of pay, manning levels, conditions and benefits. Registration under an open registry, however, gives the shipowner complete freedom in determining the nationality of his crew and agreeing rates of pay.

The easy access to capital markets is also a consideration of the shipowner when deciding where to register his vessel. Raising funds in the international capital market in order to finance the acquisition of a vessel may present insuperable difficulties not only for operators in third-world countries, but also for those in state-controlled economies such as China. Western banks may simply not be prepared to advance funds to enterprises established in countries with a history of default in the repayment of foreign currency loans or whose legal systems may present obstacles to the enforcement of a lender's security. Hence, the shipowner may distance himself from the economic and political situation of his country by registering his vessel under an open registry. This enables a financing institution specialising in the shipping industry to proceed with a transaction in the knowledge that it is dealing with a legal system with which it is familiar and that its security will be enforceable in the ordinary way.

One of the political factors that should be taken into account is the ability of the vessel to trade world-wide without any restrictions imposed by the flag state with regard to the carrying of cargo to certain countries against whom embargoes or boycotts have been applied. It is also worth considering the avoidance of discrimination against vessels trading under certain flags. For example, Taiwanese operators invariably flag their ships under open registries since Taiwan is recognised as a state by only a small number of nations.

Another serious consideration is whether the body of law and / or governmental regulation puts serious obstacles in the way of a sale of the vessel in the international market. Given that the local market may not be active, it is important to the lender that it be able to speedily de-register the vessel so that it can be sold elsewhere.

Bareboat Registries

One of the most controversial developments in the ship registration field in recent years have been the increasingly widespread practice whereby a vessel registered in one state is permitted to fly the flag of a second state for a determinate period. This situation generally arises as a result of a bareboat charter whereby a vessel registered in State A is chartered for a fixed period to nationals of State B who, during the charter period, operate the vessel under the flag of the latter state. During the charter period, the primary registration in State A is cancelled or suspended but becomes fully effective once again upon termination of the charter. In Singapore, bareboat registration is provided for under Part VI of the Merchant Shipping (Registration Of Ships) Regulations.

The bareboat registration system has been adopted with enthusiasm both by the shipowning community and by the governments of which permit these kind of registration. For the former, they can take advantage of the lower crewing costs in developing countries, and for the latter, such a system allows training and employment of local seafarers, receipt of foreign exchange, acquisition of technology 'know how' and expansion of the national fleet.

One of the features most attractive to shipowners of the bareboat registration system is that by 'flagging in' to a country with a low-wage economy, they were able to employ as crew members nationals of the 'flagging' in state at local rates of pay, thus escaping the stigma of operating under a flag of convenience for this advantage.

The bareboat registration system demands a close nexus of interest and intent between owner and charterer and many such arrangements do contain an element of artificiality. In many cases, the arrangements are entered into merely to enable savings in crewing costs or to enable the owner to take advantage of subsidies or cargo reservations in favour of national carriers in the flag state. Accordingly, in many cases, notwithstanding the bareboat charrter arrangements, the vessel remains subject to the control of the owner; often this control is secured by a time-charter back from the purported disponent owner to a subsidiary of the legal owner.

Financial institutions are however not very welcoming of the bareboat registration system. This is because registration of a vessel in more than one state would detract from the security afforded

by a mortgage recorded in the registers of a single state, whose flag the vessel flies. The nationality of the vessel provides the basis for state jurisdiction and the legal bedrock for the effective constitution of mortgages. The absence of a single nationality leads to the obvious danger that a port state might ignore a vessel's ostensible nationality and apply its own laws to any dispute submitted to its jurisdiction. Mortgagees are obviously hesitant in allowing the enforcement of their security to be left entirely to the lex fori at a port where the vessel may happen to be, instead of the vessel's national law being applied to determine the existence, nature and extent of the mortgagee's rights over the vessel.

Under rule 35 of the Merchant Shipping (Registration Of Ships) Regulations, provisions of the Merchant Shipping Act ceases to apply during the suspension of the registry of a Singapore ship. However, the provisions of the Act relating to the law governing mortgages of a Singapore ship is excepted under this rule and would still apply notwithstanding the suspension of the registry. However, there is still the fear that a port state may not apply Singapore law in determining any dispute that may arise in relation to a ship mortgage that has been registered in Singapore.