SHIP FINANCING SECURITY UNDER SWEDISH LAW

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In the earliest of the classical sea tales there appears an account of the seafaring Phaiakians, who would help any wind-driven stranger stranded on their coasts back to his native shore. Such, indeed, was their solicitude for the luckless hero that for the performance of their self-appointed task they fitted out a ship with a complement of fifty-two men—who on their way back had the misfortune to be turned into stone by an ill-humoured god.

The Phaiakians are described in the Odyssey as a rich and mighty community. Yet if their liberality to wind-driven castaways was a regular practice, their wealth cannot have lasted long, for the fitting out and manning of ships has always been a costly undertaking, and either ready cash or adequate security has always been required of the person for whom these services are performed. Early in history we find mention of security devices specially designed to meet the needs of shipping finance,[1] and such devices have grown in importance and complexity until the present day. Many circumstances have contributed to make these problems more acute today than ever before: the enormous increase in ship sizes, the rapid technological development, and the growing specialization of modern shipping. Such circumstances have resulted in a swift obsolescence of older tonnage, a great sensitivity to changed trade patterns, and a considerable need for new construction. Moreover, the trend towards larger units is itself a problem: a big modern tanker may easily cost twelve million dollars, a container vessel or a passenger ship even more.

Although the risks in modern shipping are different from those that confronted the homeward-bound Phaiakian ship and its unfortunate crew, ship financing is still in many ways a hazardous business. In this article we shall consider some of the difficulties besetting the modern financer working in a Swedish environment. Our theme is the use of the ship as security, and the various corporate devices which are sometimes employed will not be dealt

[1] See esp. Ashburner, *The Rhodean Sea-Law,* Oxford 1909, pp. ccix ff.

with. It will be useful if we first consider the various objects that may require finance and the security devices available to the financer, before turning our attention to any specific security problem.

I. THE OBJECTS OF SHIPPING FINANCE

Finance may be needed at all stages of a ship's life, and for different purposes. We may distinguish the following four objects of finance: (1) ship construction, (2) purchase of used ships, (3) equipment for a ship's permanent needs, and (4) repairs and deliveries for a ship's running needs.

Finance for ship construction may be provided either by the shipyard or by the buyer; alternatively the costs may be shared by both parties as construction proceeds, in the form that the buyer pays instalments covering a portion of the building price. In all these situations the funds used for the building will mostly originate from a bank or other finance institution.

Until recently finance by the shipyard was traditionally limited to the building period; payment was due, at the very latest, when the ship was delivered, and often the buyer would have been required to advance considerable amounts before that. The usual arrangement was payment by instalments, the first of these falling due upon the signing of the construction contract. In late years, however, international competition has forced Swedish shipyards, like shipyards in other countries, to extend high-marginal credit over long periods after delivery, and nowadays it is common for as little as 20 per cent of the price to be paid upon delivery, credit for the remaining 80 per cent being extended over a period of many years.

Any payments by the buyer before delivery of the ship must be regarded as part of the financing, and these, too, give rise to security problems of the kind which will be considered in this article. Later payments by the buyer to the yard present no security aspects and will not be dealt with here.

The immediate financer will often need refinancing by a bank or other finance institution. Such refinancing may become necessary at any stage of the ship's life, and it always involves the problem of finding sufficient security for the financer. A yard that

has undertaken to produce a ship to be paid for substantially upon delivery, or has agreed to extend credit to the buyer after delivery, will usually need refinancing either by its permanent business financer or by a lender who is willing to undertake the future financing of the particular ship. A buyer who does not obtain sufficient credit from the yard will require to be financed by a permanent lender who will rely on the ship—or perhaps a fleet of ships belonging to the buyer—for security. Sometimes the buyer may need additional capital in the course of the ship's life, and the permanent financer may be prepared to grant him such loans in order to consolidate the buyer's business, or in order to enable him to repair or convert the ship so as to maintain or increase the value of the security.

The buyer of a used ship must generally be prepared to pay in cash for the vessel when it is delivered. He may then be able to persuade the ship's permanent financer to allow the original loans to remain, but he will usually have to find new credit from another lender. In rare cases the seller may provide finance in the form of an instalment sale with payment after delivery.

Equipment for the ship's permanent needs is usually provided in the final stage of the construction work, and the supplier will then often have allowed the yard to defer payment until the next instalment (i.e. the one falling due on delivery of the vessel) has been paid. The supplier—or a financer standing behind him—will need security in the ship or materials for such credit.

There remains the credit for the ship's temporary needs. In earlier times, when it was almost impossible to have funds available for all contingencies, suppliers in foreign ports would have to rely on the master's word and on the security that the ship and its cargo might afford. There may still today be a certain call for such security, but the need for it has been lessened by the development of communications, by the introduction of new means of transferring money, and by the building up of comprehensive agency networks.

II. THE SECURITIES

The various security devices available in Swedish law have their fixed places in a priority system to be found in Chap. 17 of the Commercial Code. It will be convenient to deal with the maritime securities in the order in which they rank in this list, after making a general observation regarding their preferential character.

Historically, certain claims in respect of ships have been regarded as "claims against the ship" and as such have enjoyed priority in the ship, while involving no personal liability for the shipowner. The maritime creditors have excluded all others from sharing in the proceeds of the ship, but at the same time they have been restricted to the proceeds or value of the ship as a source of payment. Although the *raison d'être* for this system no longer exists in Swedish law,[2] there may be perceived within the priority list in Chap. 17 of the Commercial Code a separate order of priority for claims which can apply to ships. An execution of the ship, even in bankruptcy, is in principle a separate affair between the holders of such claims, and only the surplus is turned over to the general estate.

The maritime priority system is composed partly of unique shipping-law components, such as the maritime lien. Other rights within the system, such as the ship mortgage, are copied from the general law. There also enter into the system elements which are part of the general priority order, such as proprietary rights and the repairer's possessory lien. The special maritime priorities, in fact, are entwined in the body of the general priority list, whose application is largely excluded with regard to ships.[3] The co-ordination of these priorities with the remaining general priorities sometimes creates certain difficulties.[4]

a. Proprietary interest in the ship

The concept of property as understood in Swedish law covers an aggregate of elements, not all of which need simultaneously be united in one person, because the complete property is conceived of as being acquired by stages.[5] In relation to real security problems the essential element in property is the right of an owner to

[2] See my *Kreditsäkerhet i fartyg* Stockholm 1968 (hereinafter cited as *Kreditsäkerhet*), esp. pp. 26 f.

[3] This exclusion is effected in various ways. By executive rules only claims secured by a special preference in the ship are entitled to share in the distribution of the proceeds after a forced sale; see *Kreditsäkerhet*, pp. 292 ff. The ordinary pledge, which would be incompatible with the maritime priority system, is made inapplicable to ships by a special enactment.

[4] In particular this is true of workmen's priority in an employer's bankruptcy. In maritime law as well as in land law the rule is that wage claims rank before mortgages; thus the seamen's lien takes precedence over ship mortgages, and land workers' wage claims rank before land mortgages. But if a ship under construction is mortgaged, the order is reversed and the yard workers' claims must be postponed. See on this question *Kreditsäkerhet*, pp. 214 f.

[5] See Lagergren, *Delivery of the Goods and Transfer of Property and Risk in the Law of Sale*, Stockholm 1954, pp. 61 f.

recover belongings of his which are in the hands of a bankrupt possessor and to enjoy immunity from execution by the possessor's creditors. Thus, although Swedish law does not recognize any unitary concept of property, it is possible to speak of a proprietary interest as one involving protection against a possessor's creditors and other third parties.

"Constitutum possessorium" and the recorded chattel sale

Since the interest of third parties is involved, the law strictly limits the freedom of contracting parties to decide the moment at which this essential element in property shall pass. The basic rule is that creditor protection does not pass by mere contract but requires the physical transfer of the object to the buyer. A recording statute from 1845 allows creditor protection to be obtained by means of a public announcement and recording, but the statute is considered inapplicable to ships of such a size that they can be mortgaged,[6] and the only vessels sold by this method appear to be pleasure boats and other small craft.[7]

In the absence of an effective recorded conveyance it has been assumed that the ordinary requirement of physical transfer of possession cannot be applied to ships, and that these must be assignable by mere contract.[8] This view is supported almost exclusively by the authority of those who hold it,[9] and neither positive law nor reason seems to support this particular departure from the ordinary principles relating to chattels.[10] There does in-

[6] Under the Ship Mortgage Act, 1901, sec. 1, ships of not less than 3 tons net register, or in the case of icebreakers and tugs, 10 tons gross, can be mortgaged.

[7] The recording procedure has been used mostly as a means of obtaining security for the finance of shopkeeping fixtures and the like, and as security for personal loans. In the latter function motor boats and yachts have sometimes figured among the objects sold and not delivered.

[8] Undén, *Svensk sakrätt,* vol. 1, *Lös egendom,* 5th ed. Lund 1966, p. 127, Karlgren, *Säkerhetsöverlåtelse,* Stockholm 1959, p. 222.

[9] One appeal court decision (SvJT 1933, p. 54), which has been cited in support of the criticized view, holds that since a ship of mortgageable size cannot be assigned by a recorded sale, it must be assignable by mere contract. This is inconclusive reasoning, since the reason for the non-availability of the recording device might as well have been that the possiblity of mortgaging the ship filled the requirements. The problem is extensively discussed in *Kreditsäkerhet,* pp. 69 ff.

[10] It is sometimes said that the physical transfer rule is not to be regarded as a basic rule for all chattels, but as an exception from a more general principle, and that its applicability must therefore require special support. However, the recording statute, which is the legislative basis of the rule, applies by its wording to all chattels ("lösöre"). Although it is possible that the statute was not originally applied to ships, there was no valid reason for this exclusion until 1901, when the Mortgage Act came into force. After that

deed exist the vital distinction that ships capable of being mortgaged are registered, but the authorities are unanimous that no third party protection is obtained by an entry in the ship register.[1]

The result is that in the case of ships there is probably no way for the buyer to obtain an effective protection against the seller's creditors without physical transfer of the ship. A *constitutum possessorium,* or agreement to allow the ship to remain in the buyer's hands under another title, will not have that effect, and this is so even if the parties effect a temporary delivery followed by a redelivery upon the terms of a lease. The test is whether it was originally intended that the previous owner should continue to possess and operate the vessel.[2]

In spite of the authorities it is possible that the ship register may have a certain importance for the acquisition of third party protection where the sale can be shown to have been seriously intended and the buyer assumes the functions of a shipowner.[3] But the registration as owner involves certain inconveniences and risks that a mere financer will not be disposed to shoulder. Even if the legislator should decide to extend the effects of the ownership registration—which may happen in the comparatively near future—the ship register will never become an expedient instrument of security. Better methods exist.

The conditional sale

While it is not possible in the Swedish law of chattels to *acquire,* by mere contract and without physical transfer, an interest protected against the seller's creditors, the seller of a chattel may *reserve* rights which he already possesses, and can thereby preserve his protection against the buyer and his creditors even after delivery, as long as the purchase money has not been paid. This is done by means of a proviso in the sales agreement, known as a reservation of title (*pactum reservati dominii*); it requires neither form nor registration. There is no doubt that the reservation can be made with regard to ships new and old as well as in respect of ordinary chattels.

date the incompatibility of two simultaneous recording systems, both of which can serve as security devices, furnishes a sufficient ground for the exclusion of the recorded chattel sale. This does not imply, however, that ships must now also constitute an exception from the physical transfer rule.

[1] Undén, *op. cit.,* p. 127.

[2] See Hellner, *Köprätt,* 3rd ed. Stockholm 1967, p. 193.

[3] *Kreditsäkerhet,* pp. 72 ff.

In its pure form the reservation of title rarely, if ever, occurs in transactions involving ships. One reason for this is that the reservation may bring the Conditional Sales Act—which is manifestly unsuited to commercial transactions of all kinds—into play.[4] Sometimes, however, ships are bare-boat chartered on terms designed to pass the ownership after the expiry of a certain term—often after the declaration of an option and the payment of a nominal purchase sum. The reason for this practice is usually not so much the creation of security as a desire to avoid capital gains tax or stamp duty in connection with the sale. It is doubtful whether the parties can escape the application of the Conditional Sales Act when this form is used.[5]

From a security point of view the reservation of title is unsatisfactory, mainly because the nature of the transaction is not apparent to third parties and may give rise to conflicts. The same is largely true of hire-purchase transactions and hire combined with purchase options. The danger stems from the possibility of a third party acquiring rights in the ship by application of the principles of *extinctive acquisition.* For chattels the general principle is that a *bona fide* third party who has acquired a recognized right *in rem*[6] is protected, provided he obtained his title from a possessor and has himself come into possession of the chattel.

The object of extinctive acquisition may be ownership. But the buyer of a merchant ship must check the ship's register and he is not in good faith if he buys the ship from one who is not its registered owner. A conditional buyer would normally register as owner, though it is probably competent for the seller

[4] The Act is designed to protect the buyer and is mandatory for this purpose. Its inappropriateness for commercial relationships may be demonstrated by two examples. Under sec. 2 the buyer is allowed a liberal margin of delay before the seller can institute a repossession action, and even after this margin has been exhausted an effective payment may be made before repossession if the buyer's personal difficulties can be considered to warrant this. From sec. 17 it would appear that arbitration clauses would be invalid.

[5] This presupposes, of course, that it can be shown to have been the parties' intention that the property should pass, *Kreditsäkerhet,* pp. 45 f. Option clauses may be used without any such definite intention, see Sundberg, *Om ansvaret för fel i lejt gods,* Stockholm 1966, pp. 346 f. Sundberg considers the Act to be entirely inapplicable to all commercial relationships, see *op. cit.,* p. 350; cf. also on this question Falkanger, *Leie av skib,* Oslo 1969, pp. 37 f., where the learned author is inclined to deny the applicability of the Norwegian Act to ships.

[6] The recognized rights *in rem* of the law of chattels are three in number: ownership, pledge (including mortgage and the maritime lien), and the possessory lien ("right of retention"). Further on the distinction between rights *in rem* and rights *in personam* in the author's "Bailees' and Lessees' Protection against Third Parties", *Scandinavian Studies in Law* 1965, pp. 219 f.

to prevent this.[7] A bare-boat charterer, even if he has the benefit of a purchase option, cannot be registered as the owner, for the charterparty is not a conveyance until the option has been exercised. Thus, on the whole, the risk of third party acquisition of ownership is not insurmountable so far as transactions within the country are concerned.

The object of extinctive acquisition may also be a maritime lien. By virtue of a special enactment in sec. 275 of the Maritime Code, such liens—which never require possession—arise even if the ship is being operated by one who is not its owner, and apparently irrespective of knowledge of this circumstance on the part of the lienor.[8] Non-lien clauses and other arrangements between the conditional vendor and his buyer ought not to affect the third-party lienor's rights.[9]

Mortgages present a particular problem. If created by the buyer while his title is still subject to a condition they are invalid, even if the seller has allowed the buyer to register as owner and the mortgagee has advanced money on the faith of the entry in the register.[1] If the buyer is not registered he is unable to grant a mortgage or obtain registration. Instead it is then the seller who can grant mortgages to the buyer's detriment.

Ships capable of being mortgaged cannot be pledged by delivery like other chattels. They can, however, be charged with possessory liens, in particular the lien of a repairer, and this can happen even while the ship is being operated by a bare-boat charterer or a conditional buyer. If the owner or conditional vendor has forbidden the creation of liens, the person claiming the lien must as a rule have been in good faith, but it is a moot point whether

[7] Since the seller's right depends to some extent on his remaining in the register, he must be permitted to protect himself by opposing an unqualified entry of the buyer's ownership in case of conditional sale. There is no way for both to be entered as owners, though the buyer can possibly require to have a special note of his title inserted, by virtue of sec. 14 of the Ship Registration Ordinance.

[8] Under sec. 275 good faith is of importance where the ship is operated by a person who has taken possession unlawfully, and *e contrario* it would seem that good faith cannot be required in other cases. Such an interpretation is in accordance with the *ratio* which is supposed to have lain behind the rule, and which is in part also designed to enable bare-boat charterers and others to operate ships on the same conditions as shipowners.

[9] Thus *Kreditsäkerhet*, p. 51. But according to Falkanger, *op. cit.*, p. 330, and Sandström in *Befälhavareavtal och sjöpanträtt*, Gothenburg 1969, p. 272, the lien for master's contracts will not arise where the third party knew, or ought to have known, of the clause.

[1] Sec. 37 of Ship Mortgage Act merely provides that a mortgage granted by one who is not the true owner is invalid.

this applies to the lien for repairs where these can be shown to have been indispensable.[2]

At this stage we can already see that a mortgage would give the seller a better protection than the reservation can afford. Neither a mortgagee nor a vendor relying on a reservation of title —*nota bene* provided the latter remains on the register—loses his rights through the sale of the ship to a *bona fide* purchaser. Both of them are subordinated to the claims of maritime lienors, whether these claims be younger or older than their own, and neither has anything to fear in the way of later mortgages. But while a mortgage is always preferred to a possessory lien,[3] the reservation of title is ineffective against the claim of the possessory lienor.

Exposure to loss by extinctive acquisition is a characteristic weakness of the reservation of title, a weakness which it shares with other unregistered securities. In the case of ships the seller can improve his position somewhat by taking steps to remain on the register, but the efficacy of the ship registration for that purpose is neither complete nor entirely indisputable. Other aspects reveal further defects of the security and further underline the superiority of the mortgage. A mortgagee enjoys the advantages of widespread international recognition of his title, based on conventions and comity.[4] If the ship is damaged or wrecked he is automatically covered by the owner's hull insurance, and he has a well-oiled mechanism at his disposal for the exercise of his rights against the insurer.[5] Neither of these advantages can be counted

[2] Cf. *per* Mr. Justice Alexanderson in 1936, N.J.A., 650, 657.

[3] This is contrary to the normal rule in Swedish law, which places mortgages in a comparatively unfavourable position (possessory liens come under sec. 3 in the priority chapter; industrial charges, which replace certain types of mortgages of similar rank, appear under section 8; and land mortgages are found under section 9), but the precedence of the maritime mortgage was introduced in order to implement the 1926 Brussels Convention. In Norway and Denmark the legislator never formally reversed the order, and the courts have continued to subordinate the mortgages to possessory liens.

[4] Thus the Brussels Convention 1926, art. 1, and the Brussels Convention 1967, art. 1. So also Rabel, *The Conflict of Laws*, vol. 4, Ann Arbor, 1958, p. 111; Schaps-Abraham, *Das Deutsche Seerecht*, vol. 1, 3rd ed. Berlin 1959, p. 408; Abraham, *Die Schiffshypothek im deutschen und ausländischen Recht*, Hamburg 1950, pp. 313 ff. The mortgagee also has the same means as the owner of preventing a transfer of flag. According to sec. 28 a of the Ship Registration Ordinance, which has been in force since July 1, 1967 (S.F.S. 1967 no. 117), the ship cannot be removed from the Swedish register without the consent of the mortgagees, and removal from the previous register is usually a prerequisite for registration in a new one, see *Kreditsäkerhet*, pp. 168 f., 198 f.

[5] Further on this *infra*, pp. 229 f.

upon by the vendor who merely relies on a reservation of title.[6]

But in particular, the reservation of title is unsuitable from a general point of view. Its secret character invites fraud upon third parties. In competition with a posterior mortgage it prevails over the latter, not by merely relegating the mortgage to a lower position, but by wiping it out altogether. The mortgage, on the contrary, has been created as a deliberate effort to weigh the interests of the parties, and order and predictability will be furthered if competing securities are kept within as narrow bounds as possible.

Finance of equipment

Reservations of title are not generally effective in respect of accessories necessary for the running of the ship, especially such as are to be built into the vessel. This principle—which originated in land law and has thence been extended by case law into the realm of chattels—applies equally if the sale takes the form of hire-purchase with an option clause, so long as the intention of the parties is that the property in the goods shall pass. The result of this is that suppliers of such equipment and materials get no effective security but have to act on the faith of the builder's solvency or insist on cash payment or other security.

Sometimes the form of hire is used for permanent provision of certain types of equipment; thus navigational aids such as the DECCA apparatus and telegraphic equipment are regularly provided in this way. In the latest legislation relating to real property the owner's title to accessories cannot be effectively reserved against the landowner's creditors, unless they have been installed by and for the benefit of some person other than the landowner. It would not be suitable to extend these principles quite generally into the field of shipping equipment; at least the DECCA apparatus and telegraphic equipment, for which leasing is a customary and particularly suitable form of provision, ought to be immune from the shipowner's bankruptcy, although they must certainly be said to have been installed for the shipowner's purposes.[7] But if a new and less propitious use is made of the

[6] The insurance coverage is a doubtful question. The Insurance Act, 1925, sec. 54, has a general provision for the benefit of parties having an interest in the insured goods as owners, pledgees, and in similar capacities. The Marine Insurance Plan has a special provision for the coverage of mortgagees but says nothing of conditional sellers, and it is possible to deduce that these must be impliedly excluded from coverage, see *Kreditsäkerhet,* pp. 57 ff.

[7] See *Kreditsäkerhet,* pp. 64 ff.

leasing device, it is possible that the signals from land law legislation will be followed.

b. Maritime liens

To a large extent the maritime lien may be described as a remnant from an earlier period of shipping finance. On the whole its purpose is no longer to secure finance, in the sense of deliberate credit designed to facilitate the operation of shipping, but to give protection to certain deserving creditors who lack either the strength or the opportunity to provide for their own security. As a consequence the maritime lien arises *ex lege* and without any particular arrangements on the part of the lienors.

In some circumstances maritime liens may, however, be said to secure claims for financing in the above sense. This is true of the lien for unpaid deliveries and services ordered by the master outside the home port, now due to be abolished through the introduction of the principles of the 1967 Brussels Convention. Finance of shipping can also take the form of payment of a maritime lienor's claim, in return for the assignment of all his rights or under circumstances which entitle the payor to be subrogated in the lienor's rights.[8] Thus ships' agents sometimes advance harbour dues or pilotage or other expenses, acquiring in so doing the maritime lien of the original creditor, and ships'

[8] The problem of subrogation to the rights of a maritime lienor is dealt with especially by Riska in *F.J.F.T.* 1959, pp. 305 ff. (Finnish law), and Haga in *A.f.S.*, vol. 8, pp. 526 ff. (Norwegian law). It appears that the scope for subrogation is fairly wide in Norwegian law but very restricted in Finnish law. There was until recently no published investigation of the specific problem in Swedish law, but the general problem of subrogation had been studied by Hellner in his book on the insurer's right of subrogation, *Försäkringsgivarens regressrätt*, Uppsala 1953 (with a summary in English). Swedish law, like the law of Finland, takes a restrictive view of the payor's right to be subrogated to the original creditor's claim (Hellner, *op. cit.*, pp. 382 f., mentions in the English summary payments falling under the *negotiorum gestio* doctrine and payments by mistake, beside the cases of *cessio legis* by legal enactment), but as a rule acknowledges that the subrogee, where recognized, acquires the security or priority along with the claim (Nial in *Sv.J.T.* 1937, p. 480; Almén, "Om förmånsrätt för den, som på grund av borgen infriat eller genom överlåtelse förvärvat en prioriterad fordran", *Sv.J.T.* 1916, pp. 27 f; Gedda, *Förmånsrättsordningen, Kommentar till 17 kap. handelsbalken*, Stockholm 1933, pp. 23 ff., but *contra* Lögdberg, *Studier över förlagsinteckningsinstitutet*, Uppsala 1947, p. 244, note 8). On the other hand, it is generally recognized that the claim can be assigned, and that it will then be accompanied by the security or priority. The problems of subrogation to a maritime lienor's right in Swedish law have, however, recently been analysed by Sandström, *op. cit.*, pp. 175 ff. According to Sandström no subrogation occurs when the broker appears to have paid on the shipowner's behalf, and certain tests are suggested for determining this (p. 209).

financers sometimes find it to their advantage to pay the crew's wages or other running expenses, if in return they can be subrogated to their predecessors' liens.

c. Ship mortgage and mortgage in ship under construction

The ship mortgage is the principal real security available for the finance of shipping. Created by an Act of 1901, it was originally copied from the legislation relating to land mortgages, but while the latter has been developed and modernized by later enactments, the ship mortgage remains true to the original pattern. At present ships of not less than 3 tons net register (or in the case of icebreakers and tugs, 10 tons gross) can be mortgaged under Swedish law, and this applies from the moment that the ship can be measured, her so-called measure deck having been laid, until the time that she ceases to be a Swedish ship. Mortgages in ships under construction, apart from the situation after measuring, are not recognized at present.

A mortgage under Swedish law takes the form of a hypothec, a pledge granted by the owner of the property and registered with a court of competent jurisdiction.[9] It confers upon the mortgagee the right to have the mortgaged object seized and sold in satisfaction of any due and unpaid debts in respect of which the pledge has been given. Mortgages in ships can be granted only by the registered owner, but they are invalid if the grantor was not the true owner.

Although, as we have seen, Swedish law does not recognize any unitary concept of property and does not fix any particular moment for the passing of all its ingredient rights, it is clear that capacity to grant an effective mortgage cannot be independent of the grantor's own protection against a previous owner's creditors. So long as the ship is under construction at the builder's yard only the builder can grant an effective mortgage, because protection against a seller's creditors must be taken to require possession of the ship.[1] A financer of the buyer must rely on securities available to the latter and cannot take advantage of hypothecs in the

[9] Ship mortgages for the whole country are registered with the Stockholm City Court.

[1] *Kreditsäkerhet,* pp. 211 f., Weibull, in *International Shipbuilding Contracts,* Oslo 1956, p. 72. If the buyer has supplied a valuable part to the ship, such as the machinery for a tug-boat, it is arguable that a joint ownership of seller and buyer would arise. However, such an assumption would not harmonize with the position taken by the Supreme Court in conditional sales cases, cf. *supra,* p. 218, and 1935 N.J.A. 416. It may therefore be assumed that the Court will be slow to recognize such joint ownership.

builder's property; financers of the builder need security of a less transient kind than mortgages effective while the ship remains in the builder's yard. The result is that only sparing use is made of the present limited possibility of mortgaging ships under construction.

Mortgages taken while the ship is still under construction occur, therefore, mostly where the shipyard has granted the buyer long-term credit which is financed by a lender supporting the yard. Otherwise mortgages are usually delivered to the financer when the ship is delivered, and loans before delivery are secured in other ways. Mortgaging also occurs in connection with loans needed for the rebuilding of ships and other loans which may become necessary in the course of the ship's existence. Where a ship is sold within the country a previous mortgagee may consent to continue to finance the ship on the security of existing mortgages, or the buyer may have a financer of his own who will take over the mortgages as security for a new loan.

Ship mortgages in Swedish law are always separate for each ship. "Fleet" mortgages are not permitted. The result is that financers of entire fleets have to over-mortgage each ship considerably, to make sure that the entire value of the ship can be used to cover deficits which occur in the sale of other ships.

d. Advances for ship construction

The difficulties of finding security during the building period are mitigated by the existence of a special priority for advances paid towards the completed ship.[2] The priority is obtained by registration of the building contract at the nearest city court, and it can be transferred by the buyer to a lender who finances the building. In practice this priority is of doubtful value[3] and it is likely to be abolished in the comparatively near future.

e. Industrial charge

In Swedish law a land mortgage includes buildings on the land and accessories thereto; in the case of industries it also includes stationary machinery on the premises which is intended for the operation of the works. A land mortgage does not cover rolling equipment such as trucks and cars, or materials intended for con-

[2] Sec. 3 of the Maritime Code, with priority according to Chap. 17, sec. 5, of the Commercial Code.

[3] See *Kreditsäkerhet*, pp. 252 f. A remarkable deficiency is that formally there exists no way of proving the claim in the builder's bankruptcy, after the ship has been registered, *Kreditsäkerhet*, p. 294.

struction, or stocks of the finished product, nor does it embrace outstanding claims and other rights pertaining to the business, though the aggregate value of such property may be considerable. These assets can be covered by a floating charge (hereinafter referred to as "industrial charge"),[4] which is not in the nature of a pledge but attaches to the proceeds of any property of the above-mentioned character which is in the hands of the debtor at the time of execution. In the shipbuilding business the charge covers materials and parts as well as ships not yet capable of being mortgaged, but apparently does not cover claims for payment of ships which have already been delivered. The exclusion of ships capable of being mortgaged greatly diminishes the value of the industrial charge for shipbuilding purposes, since newbuildings on the slipway often represent a considerable part of the total investments in the yard.

III. PROBLEMS CONFRONTING THE FINANCER

From this point onwards our interest will be focused on some of the problems confronting the regular ship financer, usually a bank or a government fund or an insurance company which has lent money to the shipowner on the security of mortgages in the ship. Since many of the financer's difficulties are shared by other security holders, the position of these will be impliedly covered, and sometimes expressly compared. Moreover, the other securities must be considered to the extent that they compete with the mortgage, because they are then an element in the description of the mortgagee's situation.

a. Ship value fluctuations

Ship values are subject to great fluctuations, which are due largely to the inherent instability of the freight market but have been aggravated in recent years by the rapid increase of ship sizes and the growing specialization characteristic of modern shipping. Although this presents a problem to all shipping financers, long-term finance is most acutely affected.

Now, ship values are not capable of being defined by a single unitary formula, and it is not all such values that fluctuate. We

[4] *Företagsinteckning*, according to the Act of July 29, 1966 (Industrial Charges Act).

may distinguish a *building value* which is the building cost of a new vessel diminished by annual depreciation until the vessel has been written off completely; a *market value* which represents the earnings that a normal owner hopes to make on the ship and which therefore fluctuates with the current market freight; and a *utilization value* which represents the earnings that the actual owner hopes to make and which therefore depends on the employment which the owner has found for the ship. If the ship is engaged upon a long-term charterparty for the ten or fifteen years during which it can be expected to run profitably, the freight provided under that charterparty, minus the costs of running the ship, represents the utilization value of that vessel.

By entering into a long-term charterparty with a reliable and financially solid charterer the owner can therefore largely neutralize the effects of the fluctuating freight market. The charterparty has a steadying effect on the utilization value of the ship: in times when the freight market is depressed she retains her value, while in times of boom she will not share in the general rise of ship values because the owner is bound to let her continue the performance of the contract. This steadying effect of a long-term charter is realized by many tanker owners who let their ships for extended periods to the large oil companies.

It is understandable that under these circumstances the financer has an interest in sharing the stabilizing effect of the long-term charter. The loss of an increased market value in times of rising freights is of no great concern to him, for he counts on the ship as security only to the extent of her original value, determined on the basis of the charter hire, and his real concern is for the maintenance of the value in times of sinking freights. Indeed the financer is actually more interested in the charterparty than the owner is, because to the latter the depressive effect of the charterparty in a rising freight market is a decided disadvantage.

The utilization value which lies in the ship's employment on a favourable charterparty cannot be realized unless the prospective buyer acquires the right to earn the charter freight by continuing to perform the contract. Thus if the charterparty can be tied to the ship, the utilization value can be realized at the sale. But if the charterparty is extinguished by the sale, the price of the ship will be determined by the current market freight.

Under Swedish law the charterparty does not survive the sale. This is a well-established principle, supported by various con-

siderations. In the first place the relationship between the parties is considered to be of a fiduciary kind in which the person of the shipowner is important to the charterer.[5] Thus if the ship is sold at a time of decreasing freights, the charterer can always repudiate the contract and secure a cheaper freight on the market. But even if the charterer should wish to continue to perform the charter, as he might in the event of a rising freight market, the charterparty cannot be maintained, as this would be in conflict with the general principle that "the lease is broken by sale".[6] The latter difficulty can be overcome to some extent by the device of a one-ship company which owns the ship and whose shares can be taken over by the buyer; but in these cases the charterer will usually have required special guarantees from the real shipowner.[7]

While, therefore, the charterparty cannot be effectively tied to the ship so as to follow it when it changes hands, it is not uncommon for a financer to take a long-term charterparty as collateral security additional to the mortgage, by way of pledge or assignment. There is no substitution of the carrier, but the freight accruing is reserved as the lender's security. Charterparties are sometimes made a long time in advance for ships still unbuilt, and in such cases they might be used to fill the gap in security during the building time: the prospective shipowner, having signed a favourable charterparty, could approach a shipyard, which might undertake to build the vessel upon the security of the charterparty. It would then lie in the yard's interest to finish the ship on time, so that she might begin to perform the charterparty on the agreed date. In a similar way, the charterparty might be assigned or pledged to a bank or other lender financing the construction.[8] In either case the essential matter is to preclude payment of the charter hire by the charterer directly to the shipowner.

As a general rule in Swedish law contractual rights can be assigned, if they concern money payments or other neutral kinds of performance.[9] There is no form requirement, not even writing, and notice to the debtor is sufficient to preclude effective payment to the assignor. Under this rule the assignee of a charterparty would be protected by mere informal notification to the

[5] See Braekhus in *International Shipbuilding Contracts,* pp. 24 f., Weibull, *op. cit.,* p. 76, and *Kreditsäkerhet,* p. 102.

[6] See my previous article in this journal, *Scandinavian Studies in Law* 1965.

[7] *Kreditsäkerhet,* p. 102.

[8] *Kreditsäkerhet,* p. 103.

[9] Regarding the general principle, see Rodhe, *Obligationsrätt,* Stockholm 1956, pp. 134 ff., and Tiberg, *Skuldebrevsrätt,* Stockholm 1967, pp. 29 ff.

charterer, though a written assignment might be necessary if he wishes to claim the charter freight for himself.[1]

However, the debtor's interest imposes certain limits to the right of assignment which might be relevant to the time-charter situation. In some situations claims arising out of mutually binding contracts are considered incapable of being either assigned or pledged. Especially in long-term relationships such as leases, such transactions are thought to affect the lessee's position, by allowing interference by a third party in the lease relationship. Similarly in our situation, an assignment or pledging by the carrier of his interest would amount to a binding agreement with the assignee to maintain the charterparty and abstain from changing or terminating the contract by agreement with the charterer.[2]

An assignment or pledging of the charterparty should, however, be perfectly effective provided it is approved by the charterer. Such procedures are indeed practised to a great extent. But is should be realized that the security value of the charterparty, thus used, is not great. If the charterparty concerns a named ship only, it is extinguished by the sale of the ship; if it allows substitution of the ship, it is still no security against the shipowner's bankruptcy or failure to perform. The latter difficulty might possibly be overcome if the charterer can be persuaded not only to approve the assignment of the freight but also to approve the lender or a person named by the lender as a possible substitute of the owner.

The dissolutive effect of the sale can, however, be overcome only by registration of the charterparty. Such registration is not available in Swedish law, but it would seem capable of fulfilling a useful function.[3] When a charterparty is made for a ship still unbuilt, none of the parties—charterer, owner or lender—can be certain of future developments on the freight market, and they wish to determine their relationship for a long period by means of the long-term charter and the loan agreement. The situation would now seem to invite the making of a tripartite agreement to the effect that the charterparty should be registered and thereby made binding for the ship, even in the event of a sale. This would involve a possible substitution of the shipowner, and

[1] Rodhe, *op. cit.*, p. 172, and Tiberg, *op. cit.*, p. 42.

[2] Ussing, *Obligationsretten*, 4th ed. Copenhagen 1961, p. 234, and Tiberg, *op. cit.*, pp. 31 f.; cf. Undén, *Om panträtt i rättigheter*, 2nd ed. 1923, pp. 142 ff., and generally Rodhe, *op. cit.*, p. 136 at note 8.

[3] For what follows, see *Kreditsäkerhet*, pp. 106 ff. Indeed, registration is available in Norway and Denmark and compulsory in France (law of January 3, 1967, on the status of ships, decree October 3, 1967).

for this purpose it would be suitable to arrange that the register should indicate the persons whom the charterer accepts as possible substitutes for the original owner. If the charter freight is higher than the market freight prevailing at the time of the sale, the prospective beneficiaries under the contract will be prepared to pay more than others; if the charter freight is lower than the market freight, any bidder must be prepared for the charterer's insistence upon the contract, and the price of the ship will be depressed accordingly. In this way the stabilizing effect of the long-term charter might be realized.

The effect of such a registration in the event of a forced sale must depend to some extent on the existence of prior rights in the vessel. A bidder within the favoured circle can always rely on the maintenance of the charterparty and bid accordingly. But when the charter hire is low, the charterparty becomes a charge upon the vessel, and the question is whether the charterer's rights can be retained. This must depend on the position of prior rights, and the charterparty must be sacrificed if this turns out to be necessary for the satisfaction of maritime lienors or prior mortgagees. Normally there will be no prior mortgage holders, and the lender can pay out the lienors if the maintenance of the charterparty is of sufficient value to him.

b. Risk of damage and destruction

In the past no risk to shipowners or lenders was comparable to that of shipwreck or other marine disasters. While to the permanent financer other risks may nowadays loom larger, the protection against loss through maritime accidents is still a major consideration for any investor, and it is of primary importance to short-term creditors, especially lienors. We shall now proceed to study the principal means of protection available.

Control of the use of the ship

There is in general no way in which a mortgagee can control the use of the ship in such a way as to prevent the shipowner from jeopardizing its safety. He can neither require to be placed in possession nor obtain an injunction because the owner appears to be putting the ship to a dangerous use. Normally, nothing can be done before the risk has materialized into a loss, the mortgagee's only protection being that the debt becomes payable if the upkeep

of the ship is neglected or her value is impaired.[4] Once the debt has become payable the ship may be seized and sold.

A financer might, however, contract for the right to proceed against the ship at an earlier stage. By provisions in the loan agreement he might stamp certain types of use as uncontractual, which in turn may allow him to rescind the contract, after which the ship might be seized and sold.

The creditor's right to damages and general average compensation

In the absence of an effective control over the use of the ship, the lender might be protected by sharing in certain substitutes or accessories. Freight and salvage awards, which eke out the fund available to maritime lienors, are of little practical importance and will not be considered here,[5] although it is worth pointing out that both the earning of a high freight and the gaining of a salvage award may expose the ship to risks for which one might expect the financer to be compensated by a share in the earnings. Swedish law does not grant him this remedy.

Other possible objects of the mortgage, more important than freight and salvage awards, are tort claims and general average compensation payable in respect of damage which has not been repaired. Maritime lienors are entitled to such amounts, almost of necessity, since a casualty might otherwise result in a sudden transfer of values from the maritime sector of the shipowner's property to the land sector, where according to the accepted doctrine they are inaccessible to maritime lienors.[6]

To the maritime lienors it is of great value that these additional funds can be counted upon to keep the security more constant. To them the casualty risk is a tangible reality, all the more important in view of their otherwise protected position as first lienors. The value of damage claims and general average contributions as security is not seriously impaired by enforcement difficulties, for the conspicuousness of a marine casualty[7] together with the non-recurrent character of the claim generally enables the lienors to intervene and attach the amounts before the security has become extinguished by payment to the shipowner.[8]

[4] Ship Mortgage Act, sec. 28, cf. *Kreditsäkerhet,* pp. 113 ff.
[5] See *Kreditsäkerhet,* pp. 118 ff.
[6] Maritime Code, sec. 268, subsec. 1, *Kreditsäkerhet,* p. 124.
[7] Casualties on board Swedish ships give rise to so-called maritime declarations, Maritime Code, secs. 301 ff., which are public acts and publicly notified; see on these Rein in *Gothenburg University College of Economics Publications* 1956: 3, pp. 19 ff.
[8] Cf. Maritime Code, sec. 272.

Mortgagees and other creditors have no corresponding advantage; in their case damages or general average contributions are not available to maintain the value of their security. The draftsmen of the Ship Mortgage Act rejected an extension of the mortgage to such claims on the ground that it would lead to unnecessary complications.[9] Although these apprehensions were probably exaggerated, the effect is that damages and general average contributions, as well as freight and salvage awards, form a separate fund for the maritime lienors out of which they must be paid before the proceeds of the ship can be touched. The mortgagees are never entitled to these amounts, even to such as have become available too late to be of any benefit to the lienors. This occurs where the monies are paid to a receiver after a distribution in which the lienors have been satisfied but the mortgages have not been fully paid. If the additional funds had been available originally they would have gone to the maritime lienors and thus left a greater part of the ship value for the mortgagees. Since the lienors are already satisfied, and the mortgagees are excluded by law from receiving any part of the new funds, these will fall to be distributed between the shipowner's ordinary creditors, among whom the mortgage gives no priority.[1]

In practice the absence of recourse to the special funds is not very important for the mortgagees, especially since the mortgagees can usually profit from a corresponding reduction of prior claims. Lenders generally prefer to rely on insurance, mainly the shipowner's hull insurance, which in most cases covers a mortgagee's interest. However, the absence of a right to damages might in certain cases affect the mortgagee's claim for insurance money. This may occur when the shipowner settles the damage claim with the tortfeasor. Since the mortgagees are excluded by the Ship Mortgage Act from any right to damages from third parties, they have no competence to prevent the tortfeasor from obtaining an effective settlement. But the settlement relieves the insurer of his liability and deprives the mortgagee of any right to the insurance money.[2] Only a special insurance of creditor interests affords protection against such transactions.

What has been said of settlements applies to damage settlements, but hardly to the payment of general average contribu-

[9] *Kreditsäkerhet*, pp. 124 ff.
[1] *Kreditsäkerhet*, p. 295.
[2] *Kreditsäkerhet*, pp. 125 f.

tions, which are determined in an official general average distribution in which all parties concerned participate.[3]

Insurance

To the mortgagee, then, the principal remedy for an impairment of the security lies in his right to insurance payments. An important general rule of indemnity insurance, found in sec. 54 of the Insurance Act, 1925, extends coverage to all those who have an interest in the insured property, whether as owners or pledgees or because they bear the risk of destruction. Under this rule, conditional buyers and sellers alike, maritime lienors, and mortgagees would be protected by the shipowner's hull insurance.

However, the rule in sec. 54 of the Insurance Act is not mandatory but can be excluded by provisions in the insurance contract, or the conditions to which it refers. The Swedish Marine Insurance Plan of 1953, which contains general conditions for marine insurance contracts, expressly extends coverage to mortgagees, but not to others, such as conditional vendors of a ship insured by the buyer.[4] It is uncertain whether this is sufficient to deprive such parties of their statutory right to insurance protection, and the conditional vendor does well to protect himself by requiring the owner to sign a third party insurance, accompanied by a liability bond from the insurance company, or by requiring the insertion into the ordinary hull insurance policy of special protective clauses, or by signing a separate creditor interest insurance.

The maritime lienors are in a special category, and it is essential to note their position, because it affects the rights of the mortgagees. Sec. 268, subsec. 3, of the Maritime Code expressly excludes insurance payments from the property to which a maritime lien can attach. The reason given for the exclusion was that a lienor should not be allowed to profit from a contract made by the shipowner. However, when later the Insurance Act was enacted, its rule of automatic extension of the coverage in indemnity insurance was made applicable to maritime lienors having a personal claim against the shipowner—which most lienors have. It is possible that the new rule was really an expression of a new policy, but it was stressed in the *travaux préparatoires* that there is no inconsistency between the rule in the Maritime Code and the new one in the Insurance Act. Although under the Maritime Code the lien does not of itself extend to the insurance payment,

[3] Maritime Code, secs. 212 ff.
[4] See for hull insurance, sec. 92 of the Plan.

the Insurance Act may extend the coverage of a Swedish insurance giving the lienors an independent right to the insurance money.

The Marine Insurance Plan says nothing on the subject of maritime lienors, and it was presumably intended that they were not to be included under the insurance. Nevertheless, in view of the express provision in the Insurance Act, it is very likely that if the policy does not exclude the lienors they are protected.

The mortgagees, too, are excluded by the Ship Mortgage Act from sharing in the insurance money but are expressly covered, in accordance with the Insurance Act, under the Marine Insurance Plan and under the Hull Insurance Conditions, which apply to most of the larger vessels. Under the Plan and Hull Insurance Conditions, however, their rights against the insurer are subject to all the normal defences of breach of warranties, etc., which the insurer might raise against the shipowner.[5] In this respect lienors have a better position than mortgagees.

In the event of a conflict between a maritime lien and a mortgage, the lienor's position is somewhat less advantageous. In order to obtain precedence, before the shipowner, to the insurance money, the mortgagee will usually have given written notice to the insurer, who in turn will have acknowledged the notice by returning a certificate in which he undertakes not to pay the shipowner unless certain conditions are fulfilled.[6] In addition, the shipowner will often have been required to deposit the insurance policy with the mortgagee by way of pledge.[7]

If the policy has not been pledged, the mortgagee and the lienor appear to have equal rights to the insurance money: each is excluded by the Maritime Code and the Mortgage Act, respectively, from a share in the amount, but each is assured in the eyes of the Insurance Act. Being merely assured parties competing for an insurance amount, they cannot be placed in any particular order of priority, and the insurer will have to pay the amount into court for distribution *pro rata*. If the mortgagee has taken the policy as a pledge, on the other hand, it seems that he might have a stronger claim. As a pledgee he ought to enjoy priority over the maritime lienors, who are to be regarded as assured in much the same way as the owner, although protected against him by certain rules of precedence. The insurer cannot be required to

[5] See esp. the Plan, secs. 60 and 92.
[6] *Kreditsäkerhet*, p. 130.
[7] *Kreditsäkerhet*, pp. 132 f.

make this distribution himself but should be allowed to discharge his obligation by payment into court in this situation also.[8]

c. Prior claimants

The problems of conflicting rights to ships commend themselves to being studied from a wider perspective than the mortgagee's viewpoint can afford, because they involve the application of the priority order, in which rights of various standing are entwined. Because of our interest in the mortgagee's position this study will be restricted to rights which have priority over mortgages. As the status of various proprietary rights deserves particular attention by way of contrast to the mortgagee's situation, it will be presented more fully than an exposition of the latter might require.

A general distinction must first be observed. Rights may be acquired either from one who has title to the object in question, or from one who is not a title holder. The former type of acquisition is known in Swedish law as derivative acquisition, the latter as extinctive acquisition. An example of extinctive acquisition is the *bona fide* purchase of chattels. A buyer in good faith who has received possession of the object becomes the full owner, even if the seller was a thief or derived his title to the object from a thief. The previous owner's title is practically defeated; or, to be more exact, it is limited to a right of redemption.

Other rights than ownership can also be acquired extinctively, though as a matter of principle delivery of the object is required.

Bona fide purchasers

When a motor car is sold conditionally, it is normal and indeed compulsory for the buyer to register his title forthwith. No note of the reserved ownership is made in the register. It might appear natural to adopt the same kind of procedure for the ship register, but since that register affects private-law relationships, it is important that the conditional seller should have the means to prevent the buyer from being registered unconditionally. If the seller objects to the entry of the buyer as a full owner, the registration authorities can presumably make a note in the register of the buyer's purported title.[9]

If the ship has been registered unconditionally in the buyer's name, it can be sold to a third party who is unaware of the conditional sale. The third party acquires a good title on taking

[8] See *Kreditsäkerhet*, pp. 159 f.
[9] Ship Registration Ordinance, sec. 14.

possession of the ship, thus extinguishing all the seller's rights of repossession.[1] To the seller there remains an unsecured right to the purchase money against the fraudulent conditional buyer, and also the right to any payment that is still owed by the third party buyer to the conditional buyer.

If the ship has not been registered in the buyer's name, as would be the case when the sale takes the form of a hire purchase transaction, the third party cannot pretend to have been in good faith and does not acquire a good title.[2] The same would be true where only a note of the buyer's purported title appears in the register.

Maritime lienors and mortgagees are protected against such transactions. The silent maritime lien follows the ship into the hands of any purchaser, regardless of his good faith, and it is recognized in many foreign countries. The mortgage survives the sale by virtue of being publicly registered, and it appears to be recognized in every country which has developed a modern system of law.

After a ship has become attached by the owner's creditors there arises the question whether a *bona fide* purchase from the owner can extinguish the creditors' right to proceed with the execution. In practice a sale of an attached ship cannot be followed by the delivery of possession which would be necessary for an effective *bona fide* purchase, because the ship is immobilized from the date of the attachment. In theory the situation might arise if the ship has been removed in defiance of the sheriff's orders. The buyer might then claim to be unaware of the attachment, because no note is made of the attachment in the ship's register. However, such unlawful actions usually attract a good deal of attention, and it would certainly be very difficult for the purchaser to establish his good faith.[3]

If the shipowner has been declared bankrupt, he has no powers to confer a good title on a buyer, for the bankruptcy declaration is a matter for public notice. If the buyer in turn should sell the ship, which transaction in itself would fall outside the scope of the public notice doctrine, his inability to become registered as owner after the previous owner's bankruptcy would prevent any further creation of a good title.[4]

[1] *Kreditsäkerhet*, pp. 48 f.
[2] *Kreditsäkerhet*, pp. 47 f.
[3] *Kreditsäkerhet*, pp. 269 f., 275.
[4] *Kreditsäkerhet*, p. 278.

Maritime liens

Maritime liens are derivative or extinctive. The derivative lien is the rule. Normally it raises no problems of good faith on the part of the lienor, but an exception must be made for the "master's contracts" lien, because the master's authority is limited by general principles of agency, and these make the authority dependent on the good faith of the third party.

The extinctive lien is a peculiarity of maritime law, and it is found in the 1926 Brussels Convention as well as in the new Convention of 1967. The corresponding Swedish rule is found in sec. 275 of the Maritime Code, according to which maritime liens arise where the ship is subchartered or is otherwise being operated by someone who is not her owner—e.g. by a conditional buyer or a lessee. The acquisition of the lien probably does not require good faith concerning the ownership of the vessel, and it is doubtful whether non-lien clauses in a charterparty, which purport to curtail the master's power to bind the ship, can have any effect.[5]

Maritime liens take priority over mortgages of older as well as earlier date. Instead, liens are subject to a short limitation period of never more than one year.

The maritime liens are often described as being the greatest of all the risks that threaten the maritime investor and particularly the mortgagee. It is possible that this is an exaggeration; at any rate the preponderance of these risks was not borne out in an investigation of a number of ship executions.[6] It is essential, first, to point out that many of the so-called liens in the Maritime Code are nothing else than the priority which by the rules of execution is due to execution costs and expenses for the forced sale and distribution of the proceeds. Of the remaining liens the most important by far is the seamen's lien for wages. Next in frequency, though lagging considerably behind, is the lien for the master's contracts outside the home port.[6a] This is a dangerous lien, because it encourages a systematic misuse of the master's agency as a means of obtaining large credits, and may lead to collusion between the shipowner and the contracting third party on the question of proving who made the contract. The remedy seems to be to construe the master's authority subject to a rule of reason, by which the size and value of the ship and the ease of

[5] Cf. *supra*, p. 216, note 9.

[6] *Kreditsäkerhet*, pp. 142 ff.

[6a] On these, see now Sandström, *op. cit.*, with an English summary on pp. 370 ff.

communicating with the home port would determine the normal extent of the authority. It cannot be reasonable to let the master contract on his own for extensive repairs of the ship merely because the repair yard is not situated in the ship's home port! However, there is little sign of such considerations in the opinions of the Swedish courts.

Other maritime liens than those now considered did not play an important part in the material investigated. It is clear that the liens for damages and salvage claims may sometimes become very important, but, as we have been considering in the foregoing, the mortgagee can always protect himself by means of insurance.

A special problem is presented by foreign liens. The difficulties are connected with the choice-of-law rules, for if all courts apply the law of the flag, no foreign liens can arise in a Swedish ship. The choice-of-law rules vary considerably from country to country, however; even the position in Sweden is not beyond doubt, although the weight of opinion appears to favour the application of the law of the flag.[7] The result is that while a financer can probably count on the application of Swedish law for executions which take place in Sweden, he must be prepared for the use of foreign law in foreign executions. In such cases the financer often finds it advisable to pay the debt for which the ship has been arrested, so as to avoid the foreign execution. A rapid investigation of the relevant foreign law must be made in order to determine the best course of action;[8] in some countries the application of foreign law may involve very considerable increases of the total lien charge. The risks of burdensome liens are especially pronounced in systems which grant a maritime lien for repairs—which play an important part in any ship's budget—and systems which have longer limitation periods for liens than Swedish law has. It must also be borne in mind that many countries do not recognize a maritime lien for repairs but still protect the repair yards in the form of a possessory lien which enjoys priority to mortgages.

[7] *Kreditsäkerhet,* pp. 137 ff.

[8] An inventory of a number of legal systems is found in *Kreditsäkerhet,* pp. 182 ff.

IV. SHIPS UNDER CONSTRUCTION

The rules relating to security in ships under construction present special problems, because the law is in a state of transition. The introduction of the 1967 convention on rights in ships under construction will require an effective means of mortgaging ships under construction, and various changes in the present registration procedure will be necessary, as well as an abolition of the present system of registration of building contracts with the city courts. We shall consider some of the problems arising through the new convention, in relation to the present state of the law. The present rules are here presented only as a background to a discussion of the law to be.

a. Mortgage or industrial charge?

The permanent investments in a shipyard—buildings, fixtures and stationary machinery—are usually covered by land mortgages and the owning company's share capital. In addition, the permanent financer may have taken an industrial charge upon the entire plant, covering, *inter alia,* materials on the premises and ships under construction which cannot as yet be mortgaged.

Let us assume that the yard is equipped to build only one ship at a time. If it has sufficient capital to finance the construction itself, it must be putting some of its permanent resources into the ship. If ships under construction are to be made subject to separate mortgages, they cannot simultaneously serve as security for the permanent financer's loans for the plant. In other words, some of the security upon which the financer is relying—mainly property covered by his industrial charge—is cut away, and the deficiency must be covered by short-term mortgages upon the various ships under construction, if the security is to be maintained at a reasonably constant level. This would involve the payment of mortgage stamp duty for security only during the relatively brief period of building—a security which would become useless to anybody after the ship has been delivered to a foreign buyer.

As a rule, however, the yard will either borrow money for the building or rely upon advances from the buyer. In either case it will be called upon to provide security. If the yard's permanent financer supplies the necessary funds, the security will be a mere supplement to his permanent security in land, fixtures and ma-

chinery. Here, as well as in the case of self-financing by the yard, a mortgage in the ship under construction would be an expensive form of security, and a floating industrial charge—if it can be made to cover the ship under construction—would be more suitable.

These reasons for the use of the industrial charge are strengthened where the yard builds several ships simultaneously or has investments in more than one ship at a time. Since the industrial charge covers not only products and materials, etc., but also covers—or at least must be made to cover[9]—outstanding claims for delivered ships, it can be expected to remain reasonably constant as long as the yard is fully occupied. The lender is relieved not only of the cost of stamp duty for each ship but also of the difficulty of applying for new mortgages as soon as a newbuilding is planned. It seems clear that the floating industrial charge provides a more adequate coverage for a financer of the general activities at the yard than would separate mortgages in a number of individual newbuildings.

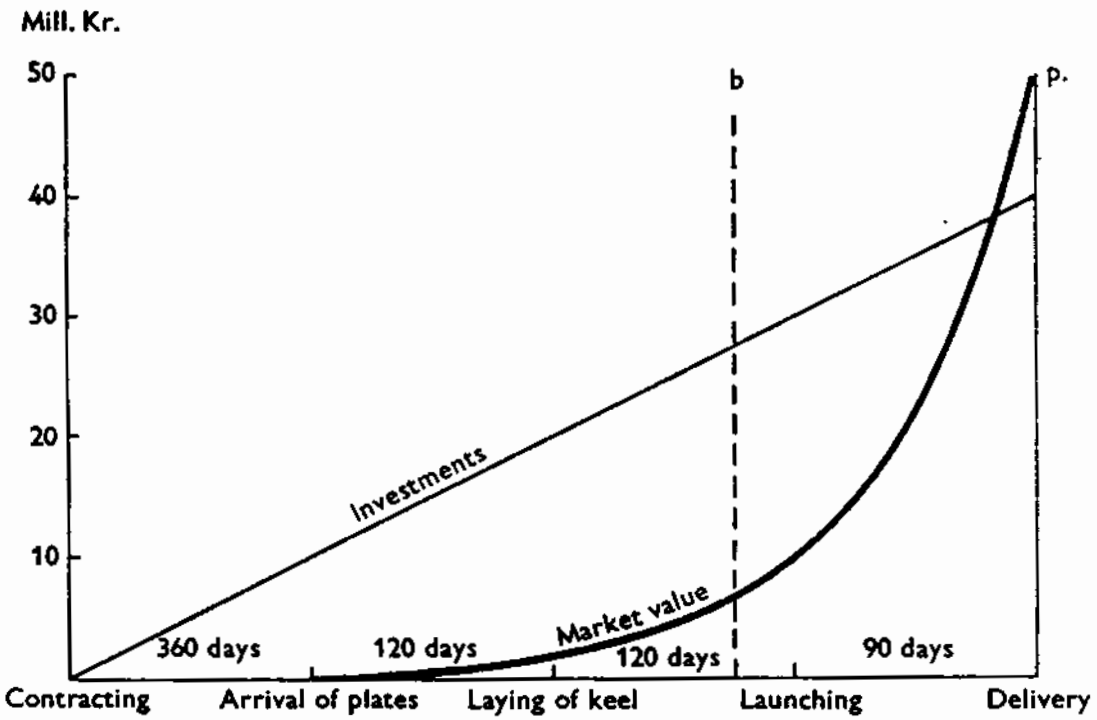
Any financer of shipbuilding who is not simultaneously financing the permanent investments at the yard is likely to rely on the individual ship for his permanent security. He will therefore want a security that can easily be transformed into a ship mortgage, and for this purpose the mortgage in ships under construction provides the easiest solution. If the completed ship is going to be of Swedish nationality, the transformation into a ship mortgage raises no problems. If it is going to be a foreign ship, the transformation may be both costly and complicated. The one thing that Swedish law can do to mitigate such difficulties is to adapt the stamp duty to the relative shortness of the normal building time. As this reduction would apparently have to be applied to all ships, irrespective of their intended nationality, payment of the balance to the present Swedish stamp duty of 0.4 per cent of the mortgage might be required before the mortgage can take effect in respect of the completed ship.

In itself, then, the ship construction mortgage is a proper form of security for anyone financing the building of ships rather than the shipyard as such. It is suitable to place the loan in a credit

[9] The Industrial Charges Act does not seem to cover these claims, *Kreditsäkerhet*, p. 202. However, the non-cover of claims for delivered ships seems to be due to a drafting mistake that should be rectified. Moreover, if the ship is not registered until after delivery, the industrial charge will cover the purchase claim even under present rules. See on the subject *Kreditsäkerhet*, p. 256.

account, from which the borrower may draw specified amounts at predetermined stages of the construction. The lender is thus assured of a correlation between the loan actually utilized and the security growing up on the slipway.

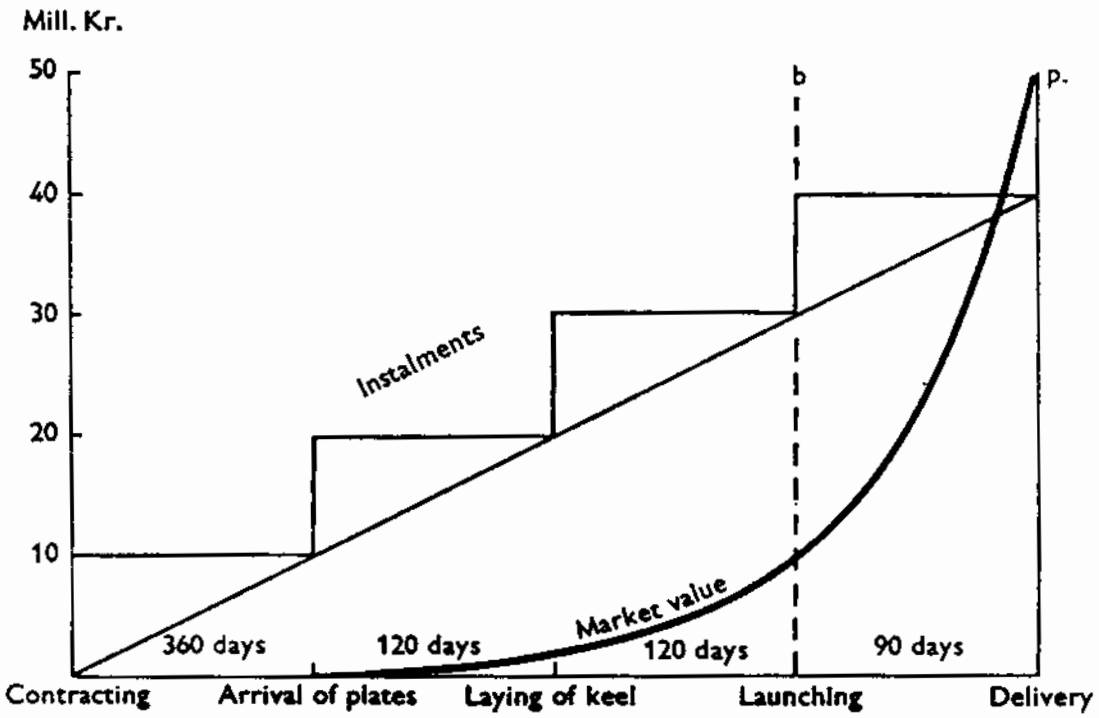
However, the correlation between loan and security is rarely adequate, because the market value of an uncompleted ship is mostly much lower than the investments which have been put into the building; only after the launching does the value rise steeply towards that of a completed vessel. Nevertheless, the newbuilding on the slipway may be valuable to the creditors, for if the shipyard goes bankrupt they can often get the bankruptcy estate as such to undertake the completion of the ship and earn the contract price upon delivery.[10] The situation may be illustrated by the following diagram:



If the financing of the shipbuilding is based essentially on the advance instalments paid by the buyer, the ship alone becomes very inadequate as security during the building period. Even assuming that the creditor could realize the whole value of the investments in the unfinished ship, the advance payment of the instalments places him at a disadvantage. If the first instalment is paid at the beginning of the construction work, or prior thereto,

[10] Cf., regarding the right of the bankruptcy estate to complete the building, the Norwegian case 1916 N.Rt. 454 (Sv.J.T. 1916, p. 411).

the structure on the slipway must in any case remain insufficient security until the instalment has been invested entirely in the building. At that time, or earlier, the buyer may have to pay a new instalment, and the security will again become insufficient until the investments in the construction have drawn level with the accumulated instalments. The insufficiency of the security can be mitigated, though far from cured, by appropriate measures in the event of the shipyard's bankruptcy (diagram 2):



On the whole, the ship construction mortgage seems to be a rather unsuitable security for advances paid by the buyer, especially when one considers the brevity of the building period and the consequent short life of the mortgage. But the buyer rarely takes out the mortgage to use only during the construction period; he assigns the mortgage to a financer who will continue to rely upon the ship for many years to come. Under these circumstances the usefulness of the construction mortgage will depend largely upon the difficulties and expense of effecting a transference into an effective ship mortgage. In this respect what was said earlier about the particular usefulness of the mortgage for the finance of Swedish ships-to-be, and the possibility of introducing a two-stage stamp duty, is again applicable. But even when the construction mortgage is used, the lender will often require collateral security during the building period, in addition

to the ship under construction. It is worth mentioning that the registration of a long-term charterparty, along the lines suggested previously in this article, offers little help in this situation. Although reliance on the charterparty might strengthen the financer's own interest in bringing about the reconstruction of a shipyard in difficulties or at least the completion of the ship, it would not alleviate his own problems in the event of the yard's bankruptcy.

The use of the industrial charge has a well-defined field of application but within its proper area does not appear to be attended by the same difficulties as the ship construction mortgage. The security can be of use only to a financer of the regular activities at the yard. The value of the security is low but on the whole rather stable, and the financer uses the charge as a complement to mortgages upon the rest of the plant. It would seem to be regrettable if the use of this form of security had to be abandoned as far as the value of ships under construction and payment claims therefor are concerned, in order to leave room for the introduction of the ship construction mortgage.

In reality, it seems possible to allow the two forms of security to exist side by side. The basic rule would then be the extension of the industrial charge to all chattels on the premises and payment claims arising in respect thereof. If the permanent financer judged it expedient, he might, however, consent to the registration of a particular newbuilding as an object capable of being mortgaged. Thenceforth that ship would be outside the reach of the permanent financer. The control of the yard's finance so obtained would enable the lender to retain sufficient security for his own investments and at the same time to facilitate new projects by releasing all newbuildings which are financed by external capital. Such a system need not bind the hands of the shipyard unduly in its negotiations with potential buyers. The yard could be specifically authorized by the financer to contract within a suitable frame, and agreements with a buyer within that frame would bind the yard, in accordance with the principles of the law of agency. It is in the interest of the yard and financer alike that the frame of action should be sufficiently wide for businesslike purposes.

If this system were introduced, it would be necessary to determine the moment at which the newbuilding becomes a completed ship, free of the industrial charge and freely assignable by mortgage. Possible moments are the launching and the delivery. Al-

though the continuance of the industrial charge—which after delivery extends to the unpaid purchase sum—is an argument for choosing the moment of delivery, it seems undesirable that the ship should have to remain unregistered until this moment. A possible solution would be to allow registration at an earlier moment, but to defer the faculty of mortgaging the ship until delivery, by means of a special note in the register.

b. Registration of the newbuilding in the buyer's name

It is a common opinion that the mortgaging of ships under construction might as well begin as early as possible, and that the interest inherent in a construction contract should be a sufficient basis for the registration of the mortgage.

Under the present ownership system, the newbuilding is the property of the shipyard as long as it remains on the premises. Since it is the yard's vessel that is going to be mortgaged, it must also be the yard's interest in the building contract that becomes the subject of the mortgage during the embryonic period before the construction work has commenced. But the yard's interest in the contract is not capable of being assigned and thus has no value; no one can force the buyer to accept a ship produced by another builder.[1] Having no commercial value, the yard's interest in the contract is not a proper object for a mortgage. Similarly, the planning and designing work which usually precedes the actual construction has no commercial value and is not a fit object for a mortgage.

The buyer's interest in the contract, on the other hand, can be assigned, and the assignment gives the builder no right to interrupt the performance of the contract as long as the payment of the purchase price is adequately guaranteed.[2] This gives the buyer's interest a commercial value, which in times of scarcity of tonnage may be very considerable. Having a commercial value, which is gradually added to by the accretion of planning and designing work, materials appropriated to the ship and labour put into it, the interest should be capable of being pledged or mortgaged.

Only a mortgage is capable of covering the newbuilding in the builder's yard, and thus if a security is to be created in both the

[1] *Kreditsäkerhet*, p. 209.

[2] Cf. Almén, *Om köp och byte*, 4th ed. Stockholm 1961, § 14 at note 3, Rodhe, *Obligationsrätt*, Stockholm 1956, p. 136, and esp. Ussing, *Obligationsretten, Almindelig del*, 4th ed. Copenhagen 1961, § 22: II; see also *Kreditsäkerhet*, p. 211.

newbuilding and the buyer's interest in the contract, it must be done by mortgaging. But this presupposes a change in the present ownership system. If the newbuilding is necessarily the builder's property, as under the present rules, it can never function as an accretion by which the buyer's interest is gradually developed towards the ownership of a complete ship. The mortgaging of the buyer's interest in the ship under construction necessitates the registration of the ship in the buyer's name at this early stage, and it is thereby a forcible argument for acquisition of a protected title by registration rather than physical delivery.

It is true that there is no necessity for including the naked interest in the building contract in the security, since this is capable of being pledged separately by contract and notification to the builder. But the fusion of all valuable interests in the ship can be achieved only if they are all vested in the buyer and included under the mortgage. All the assignable values in the ship are thereby lumped together and can be dealt with as a convenient package in a single transaction. That an exception would have to be made from the general rule that the benefit of a contract is assigned or pledged by agreement and notice is no ground for excluding the buyer's interest in a shipbuilding contract from the compass of the mortgage. Indeed, as we have already found, a similar exception exists in respect of complete ships capable of being mortgaged, for unlike all other chattels they cannot be pledged by mere delivery.

V. CONCLUSION: TRANSFER BY REGISTRATION

The results of our study seem to point rather strongly in one direction: the importance of registration as a means of creating rights and transferring property in ships. Indeed the ship register becomes a cornerstone in any modern system designed to strengthen real security in ships. As between the buyer and the builder, only the former has an original interest worthy of being registered and mortgaged. If the effect of the registration is extended to the newbuilding in the yard, the security is assured of a continuous growth by the addition of work and material, until the completed ship is delivered. Nor does the perspective end there, for the delivery becomes divested of all its spectacular third-

party effects, and the registration of rights and conveyances continues to fulfil its useful function all through the life of the ship. Let us briefly examine the various phases of the life of the ship, in the light of the various registration devices which we have been considering.

In the beginning there is usually only the building contract, although there may sometimes be a long-term charterparty even before that. Assuming that the construction of the ship will be paid for by an independent financer—who will usually continue to extend credit during the mature life of the ship—the builder's permanent financers, who have land mortgages and industrial charges upon the plant and its appurtenant assets, will be prepared to release the newbuilding for registration, so that it may be mortgaged separately by the buyer. The value of the mortgage is usually relatively low during the building time, but it may be strengthened by the addition of a long-term charterparty, which might be registered separately. The buyer may be required to insure the newbuilding against risks that are relevant during the building time, and the insurance, according to the Swedish insurance plan, will cover the lender's interest.

The completion of the ship may be accompanied by a transfer to a foreign register, which may involve certain costs and complications. If the ship remains Swedish these difficulties can be avoided, and the transfer may be arranged without involving the parties in costs or complications. The delivery of the completed ship to the buyer loses its decisive significance. The buyer's interest undergoes no sudden transformation but continues to be just the same—his ship and his charter contract.

For future dealings with the ship, i.e. after delivery, transfer by registration becomes a valuable instrument. All transactions involving the ownership of the vessel will have to be registered, and the registration authorities will have to control the transferee's title—which in practice should mean that a formal conveyance will be required. Difficulties which might now be caused by registration of conditional buyers as full owners will be avoided, for the condition should have to be registered in order to be effective. No mortgaging of the ship can be allowed while the buyer's right is subject to such a condition. Sales combined with re-leases can be allowed where this suits the interests of the parties, without any detriment to the interests of third parties.

The transfer by registration would also do away with the need for acknowledging a general *bona fide* purchase based on posses-

sion. The buyer of a ship will have to rely on the register and on that alone. But other forms of extinctive acquisition—in particular the maritime and possessory liens—would remain unaffected by the registration rule.

This paper began by a glimpse into the mythical past, and it is only proper that it should have ended with a vision of a possible future. It can do so without having to delve into the complications of the legal machinery involved, which comprise such difficulties as the pouring of two international conventions into a Swedish mould and coordinating that process with a current reform of Swedish land law, all of which will have to be done in cooperation with three other Scandinavian countries and with due observance of the need for Scandinavian uniformity. On the practical level may be mentioned the necessity for a reorganization of the registration system, which is now divided into a ship register kept by the Board of Shipping and a ship mortgage register kept by the Stockholm City Court. Nor can the reform be confined to maritime law, for the changes which are necessary will have repercussions on the rules of execution and possibly also upon the law of taxation.[3] For the legislators even the seemingly small changes may be a vast undertaking. The wheels have begun to move, one hopes in the right direction, but a long journey remains to be accomplished before a modern and coherent system of transfer and hypothecation by registration becomes a reality.

[3] The shipyards are at present unwilling to part with their ownership of the newbuildings in their yard because it allows them to make tax deductions which would not otherwise be permissible. It would seem that the taxation rules should be adjusted so that such considerations do not obscure the problem of creating an efficient security.