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## ANY OTHER BUSINESS

### Proposal to add a new output to develop a new instrument on Foreign Judicial Sales of Ships and their Recognition

Submitted by China, the Republic of Korea and the Comité Maritime International (CMI)

#### SUMMARY

*Executive summary:* This document proposes a new output for the Legal Committee to develop an international convention on the foreign judicial sale of ships and their recognition based on the draft convention prepared by CMI to ensure that the purchaser of a ship in a judicial sale can be confident of obtaining clean title to the ship

*Strategic direction:* 1 and 12.2

*High-level action:* 1.3.3

*Planned output:* No related provision

*Action to be taken:* Paragraph 10

*Related documents:* LEG 102/11/2

## 1 Introduction

1.1 This document is submitted in accordance with paragraph 4.7 of the *Guidelines on the Organization and Method of Work of the Legal Committee* (LEG.1/Circ.7) regarding the submission of proposals for new unplanned outputs.

1.2 This document provides the rationale for, and an outline of, a draft international convention on the foreign judicial sales of ships and their recognition (the draft convention) which was approved by the Assembly of the 41st International Conference of the Comité Maritime International (CMI), held in Hamburg on 17 June 2014.

1.3 Many hundreds of ships are sold each year through some competent form of judicial sale. The underlying cause or causes of a judicial sale may be numerous, but usually relate to

the non-payment of debts due and owing, and, on occasion, following forfeiture by the State. Purchasers, and subsequent purchasers, must be able to take clean title to the ship so sold and be able to de-flag the ship from its pre-sale registry and re-flag the ship in the purchaser's selected registry so as to be able to trade the vessel appropriately without the threat of costly delays and expensive litigation.

1.4 There is currently no international instrument that addresses the recognition of judicial sales. Nor is there any instrument that adequately protects purchasers from prior claims and which addresses the de-registration on re-flagging and re-registration of ships from and to national registries. Proper registration of ships is key to the sound governance of maritime safety, marine environment protection and marine technical issues.

1.5 The purpose of the draft convention is to ensure that the purchaser of a ship in a judicial sale can be confident of obtaining clean title to the ship, free of and unencumbered by any mortgages or similar liens or charges placed on the ship prior to the judicial sale and is able, against presentation of a suitable certificate issued by the court which conducted the judicial sale, to delete and re-register the ship in the purchaser's selected registry.

1.6 This, in turn, will enable the purchased ship to trade freely; and to ensure that the ship will realize a greater sale price which will benefit all the related parties, including creditors and the shipowners - and by so doing, the draft convention will promote the smooth and efficient flow of seaborne trade and a reduction in the risks associated with such trade through the cooperation of States who become parties to the convention (State parties).

1.7 The purchase of vessels is generally financed by a ship mortgage from a bank where the bank's main security for repayment is the ship itself. The draft convention will permit banks to provide ship finance confident in the knowledge that the ship will realize its full market value at a judicial sale and not the reduced value realisable where there is the risk, as at present, that the ship may be arrested for claims predating the judicial sale.

1.8 Most importantly, the judiciaries of many countries have observed that the need to recognize judicial sales by foreign, competent courts forms part of the comity of nations and contributes to the general well-being of international trade.

1.9 IMO, as the sole United Nations specialized agency with responsibility for the promotion of safe and efficient international shipping practices should, it is submitted, be part of the process in developing this much needed international framework for the judicial sale of ships.

## **2 IMO's objectives**

2.1 It is submitted that the proposal is within the scope of IMO's objectives to ensure and strengthen the linkage between safe, secure, efficient and environmentally friendly maritime transportation, and the development of global trade and the world economy. It is indisputable that the carriage of goods in ships is the cornerstone of global trade and a major driver of world economies – over 90% of world trade moves by sea.

2.2 It is further submitted that the IMO's involvement in issues of this kind has precedent as evidenced by:

- (1) the *International Convention on Maritime Liens and Mortgages, 1993* which was adopted by the United Nations/International Maritime Organization Conference of Plenipotentiaries on a Convention on Maritime Liens and Mortgages held in Geneva from 19 April to 7 May 1993; and

- (2) the *International Convention on Arrest of Ships, 1999* which was adopted at the United Nations/International Maritime Organization Diplomatic Conference on Arrest of Ships held in Geneva from 1 to 12 March 1999.

2.3 Both of these conventions were convened by the Secretary-General of UNCTAD and the Secretary-General of IMO.

2.4 It is also submitted that the development of the convention could also be linked to the effective implementation of the SOLAS requirement for a Continuous Synopsis Record (chapter XI-1, regulation 5 of SOLAS), as the convention would avoid problems with registration so that the issuance of the CSR would be facilitated.

2.5 Issues relevant to the ownership and registration of ships are pivotal to the sound administration and safety of maritime transportation. The judicial sale of ships is a regular and inevitable consequence of doing maritime business. Competently conducted judicial sales should, generally:

- (1) allow claimants to satisfy debts;
- (2) provide purchasers, and subsequent purchasers, with the security that they can trade their vessel on a global basis with the knowledge that the ship can be permanently registered in a registry of their choice;
- (3) allow purchasers to trade with the vessel and ensure that trade will not be hindered by the arrest, attachment or detention of the vessel for debts that arose prior to the judicial sale;
- (4) enhance the quality of shipping through encouraging the proper management of ships by facilitating their appropriate registration.

### 3 Compelling need

3.1 As there is currently no international instrument dealing with the recognition of foreign judicial sales of ships it can be said, with some confidence, that in this regard maritime transportation is neither secure nor efficient and hinders rather than promotes global trade and the world economy. The need for intervention by inter-governmental and international organisations has been clearly recognised both judicially and by national and international maritime bodies. The recognition of foreign judicial ship sales is fundamental to international maritime law.

3.2 The difficulties that arise when one country will not recognise an order for the judicial sale of a ship in another country has been succinctly summarised as follows:

- (1) It is an affront to the Court and the State ordering the sale;
- (2) It represents a refusal by that country to abide by the decisions of a Court in another country, and an exception to a rule honoured by every nation in the world.

- (3) If other countries, or other debtors, decided to follow this bad example, it could create confusion in the area which can be effectively controlled only with the good faith of all seafaring nations<sup>1</sup>.

3.3 The difficulty of dealing with the recognition of judicial sales at an international level has also been highlighted. In the Canadian case of the ship "*Galaxias*"<sup>2</sup> (which is summarised in annex 2) the Court noted that:

- (1) whilst a purchaser on a judicial sale will take a clean title free and clear of all encumbrances according to the laws of Canada and notwithstanding that it is clear that Canadian Courts desire and expect that the Courts and Governments of other nations will respect its orders and judgments, particularly in the area of maritime law, however this was not an area over which a national jurisdiction exercises control, nor is it appropriate that it attempt to do so;
- (2) international regulation of the judicial sales was necessary; and
- (3) in order to promote the free flow of maritime traffic, countries have, generally speaking, agreed to apply a uniform set of admiralty rules and laws. This would not, however, prevent any country from legally completely ignoring or setting aside any normally accepted practice or any law which is universally recognised in admiralty matters or even a rule of law which that country might previously have adopted by treaty. This is precisely what territorial jurisdiction means, and, until there exists some world authority with a superior globally enforceable overriding jurisdiction this is what we all must live with.<sup>3</sup>

3.4 In commenting on judicial orders for the sales of ships that did not ensure the passing of clean title, the same Court noted that admiralty lawyers and all lay people in the shipping world, involved in any way in the purchase and sale of ships, will invariably feel that this would greatly reduce the amounts which can be obtained from court sales of vessels and render some ships completely unsealable. The legitimate claims of many local and foreign creditors would thus be defeated by the resulting ridiculously low payments into Court of purchase prices<sup>4</sup>.

3.5 These views have been echoed in other judgments of courts in many jurisdictions but it is submitted that the above extracts are sufficient evidence of the effect of the non-recognition of judicial sales on efficient maritime transportation, the development of global trade and the world economy.

3.6 In order for the recognition of foreign judicial ship sales to be uniformly accepted by way of an international instrument, the intervention of the IMO in co-ordinating with other international bodies who have a mutual interest in such an instrument will be of considerable benefit to the international maritime community.

3.7 The IMO has stated that its highest priority is the safety of human life at sea with a particular focus on eliminating shipping that fails to meet and maintain technical, operational and safety management standards. As a high level action in this regard, the IMO intends

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<sup>1</sup> The Associate Chief Justice Noel in *Vrac Mar Inc. v. Demetries Karamanlis et al* [1972] FC 430 at p434 (Canada)

<sup>2</sup> (1988) LMLN 240, being a judgment of the Federal Court of Canada

<sup>3</sup> At page 11 of the judgment

<sup>4</sup> At page 12 of the judgment

keeping under review and supporting flag, and Port State implementation for enhancing and monitoring compliance.

3.8 Whilst national vessel registries may reflect the registered ownership of vessels, many registries may not, for various policy reasons, follow changes in the ownership of ships. Whilst ownership identity is nonetheless an important function of a ships' registry, the primary function of a register is to give a vessel "nationality". A vessel acquires thereby the privileges, protections and the burdens of vessels operating under allegiance to the sovereign.

3.9 It is submitted that the IMO has an interest in the efficient administration of ships' registries. The de-registration and re-registration from and into ships' registries of ships sold by judicial sale would add support both to the IMO strategic direction and to the proposed high level action.

3.10 While there has been no exhaustive compilation of data on the number of ships sold by way of judicial sale, the data from four significant maritime jurisdictions in Asia (Republic of Korea, China, Singapore and Japan) shows that, during the period 2010–2014, more than 480 ships were sold by way of judicial sale per year in these countries.

3.11 It follows that the number of ship sales that would benefit from the certainty provided by the draft convention would run to thousands of ships a year. It is submitted that this information, alone, establishes a compelling need for such an international instrument.

3.12 The courts have also noted a compelling need for an international regime dealing with the recognition of judicial sales of ships as set out in the aforementioned extracts from the judgment in the "*Galaxias*".

3.13 In addition, in the English case "*Acrux*"<sup>5</sup> (a summary of which is set out in annex 2) Mr Justice Hewson confirmed that Courts must recognise:

"proper sales by competent Courts of Admiralty, or prize, abroad – it is part of the comity of nations as well as a contribution to the general well-being of international maritime trade"<sup>6</sup>.

3.14 Whilst many judicial sales proceed as intended, problems still arise, some of which become the subject matter of further lengthy and costly judicial intervention.

3.15 There are a number of reported decisions where various problems are encountered. Summaries of the following cases that reflect the global nature of the problem are set out in annex 2: The "*Acrux*"<sup>7</sup> (England), the "*Galaxias*"<sup>8</sup> (Canada), the "*Great Eagle*"<sup>9</sup> (South Africa), the "*Union*"<sup>10</sup> (China), the "*Katerina*"<sup>11</sup> (The Netherlands), the "*Ahmet Bay*"<sup>12</sup> (USA) and the "*Sam Dragon*"<sup>13</sup> (Ireland).

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<sup>5</sup> [1962] Vol.1 Lloyds Law Reports at p405

<sup>6</sup> At p409

<sup>7</sup> [1961] 1 Lloyds Report at p405

<sup>8</sup> [1988] LMLN No. 240 at p2

<sup>9</sup> [1994] 1 SA 65(c)

<sup>10</sup> [2005] Jin Hai Fa Shang Chu Zi No. 401 – Judgment of the Tianjin Maritime Court

<sup>11</sup> [KG04/912P], LJN: DB 4789

<sup>12</sup> 623 F.SUP.2d635

<sup>13</sup> [2012] JEHC 240

3.16 If the proposed draft convention had been in force and ratified by the countries concerned, then in all probability the disputes which formed the subject matter of these cases would not have arisen and there would have been a very considerable saving of legal costs in the greater interests of the maritime industry as a whole.

3.17 Even where problems do not become the subject of further judicial involvement, the commercial and legal costs incurred in dealing with these issues are considerable, and the delays and interruptions to the owner's rights to trade the vessel severely interrupted. In most circumstances, the innocent owner is faced with a ship that has been arrested by a claimant.

3.18 As was recognised by Mr Justice Didcott (in an arrest case, not involving a judicial sale) in the South African case of the *mv Paz*<sup>14</sup> (a summary of which is set out in annex 2): "It is a serious business to attach a ship. To stop or delay its departure from one of our ports, to interrupt its voyage for longer than the period it was due to remain, can have and usually has consequences which are commercially damaging to its owner or charterer, not to mention those who are relying upon its arrival at other ports to load or discharge cargo."

3.19 In certain jurisdictions (such as China) the ship registration authorities will not accept foreign court documents as effective documents for the registration and de-registration of ships.

3.20 The proposal for approval of the final text of the draft convention was made by the China Maritime Law Association at the CMI Assembly in Hamburg in 2014. The proposal was supported by 24 acceptances with two abstentions and no vote against. The 24 acceptances comprise the National Maritime Law Associations of Argentina, Australia, Belgium, Canada, China, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Malta, the Netherlands, New Zealand, Nigeria, Norway, Republic of Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States. The two abstentions were the National Maritime Law Associations of Brazil and Poland.

3.21 The CMI, heeding the concerns of various National Maritime Law Associations, recognized that the needs of the maritime industry and ship finance required that the judicial sale of ships is maintained as an effective way of securing and enforcing maritime claims and the enforcement of judgments or arbitral awards or other enforceable documents against the owners of ships.

#### **4 Analysis of the issue**

4.1 Any uncertainty for the prospective purchaser regarding the international recognition of a foreign judicial sale of a ship and the deletion or transfer of registry may have an adverse effect upon the price realised by a ship sold under judicial sale to the detriment of interested parties and the maritime industry as a whole.

4.2 Necessary and sufficient protection should be provided to purchasers of ships at judicial sales by limiting the remedies available to interested parties to challenge the validity of the judicial sale and the subsequent transfer of the ownership in the ship.

4.3 It is important to highlight the important legal principle that flows from a judicial sale that once a ship is sold by way of a judicial sale, the ship should, with only very limited exceptions no longer be subject to arrest for any claim arising prior to its judicial sale.

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<sup>14</sup> 1984 (3) 261 (D)

4.4 The objective of the recognition of a judicial sale of a ship requires that, to the extent possible, uniform rules are adopted with regard to the notice of the judicial sale, the legal effects of that sale and de-registration or registration of the ship.

4.5 These then were the issues that the draft convention, the text of which is set out in annex 1, sought to address, as follows:

- (1) As the draft convention was to focus on the recognition of judicial sales, the structure of the instrument was, initially, modelled on the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958*.
- (2) **Article 1** provides a list of definitions which has proved most useful in keeping the balance of the articles concise. Care has been taken to align definitions with those adopted by other conventions, in particular the *International Convention on Maritime Liens and Mortgages, 1993*.
- (3) **Article 2** provides that the convention shall apply to the conditions in which a judicial sale taking place in one State shall be sufficient for recognition in another.
- (4) **Article 3** sets out the parties to whom notice of the pending judicial sale must be given. It also requires such notice to be given by the competent authority in the State of the judicial sale. The article sets out what information should be set out in the notice. In all other respects, the notice is to be given in accordance with the law of the State of the judicial sale.
- (5) **Article 4** determines the effect of a judicial sale. The basic concept being that any title to and rights and interests in the ship that is the subject of the judicial sale shall be extinguished and any mortgage or similar charge will cease to attach to the ship and clean title to the ship will be acquired by the purchaser. The sale will not, however, extinguish any personal rights that a claimant may have against the owner or any other person personally liable to the creditor (to the extent that the debt has not been extinguished by the proceeds of the sale of the ship).
- (6) **Article 5** provides for the minimum content and mechanics of issuing a certificate of judicial sale by the competent authority. This certificate confirms that the ship has been sold in accordance with the laws of the State and the provisions of the convention. The certificate is to be issued substantially in the form of a model certificate annexed to the convention. In the absence of proof of circumstances referred to in article 8, the certificate shall be regarded, in terms of article 7, as conclusive evidence that the judicial sale has taken place and has the effect provided for in article 4.
- (7) **Article 6** provides that, against production of the article 5 certificate, the registry where the ship was registered prior to the judicial sale shall delete all mortgages or similar charges and either register the ship in the name of the new purchaser, or delete the ship from that register and issue a certificate of deregistration so that the ship can be registered elsewhere. Where the ship was on bareboat charter, and was flying the flag of a state of bareboat charter registration, then the ship shall be deleted from that registry against production of the certificate.

- (8) **Article 7** provides that subject to article 8, the court of a State party shall, on the application of a purchaser, recognize a judicial sale conducted in another State where that State has issued an article 5 certificate and regard that sale as having passed clean title to the purchaser, and that the ship was sold free of any mortgage or similar charge. If the ship sold by way of a judicial sale has been arrested, or its arrest is sought, for a claim that arose prior to the judicial sale, then the court shall dismiss or set aside the arrest, or reject any application for the ships arrest. The only exception is if the arresting party is an "interested person" (defined as the pre-sale owner or the holder of certain registered charges) and is able to show that circumstances exist that bring that persons case with the parameters of article 8.
- (9) **Article 8** sets out the circumstances in which the recognition of a judicial sale will be suspended or refused at the request of the interested person. The sale will not be recognized if it is shown that the ship was not physically within the jurisdiction of the State where the judicial sale took place. Recognition will be suspended where the sale is being challenged in the court of the State of judicial sale. Recognition will be refused where it can be shown that the sale has been nullified by a competent court of the State of judicial sale or where recognition would be manifestly contrary to public policy.
- (10) **Article 9** allows State parties to restrict the application of the convention to recognition of judicial sales conducted in State parties.
- (11) **Article 10** provides that nothing in the convention shall derogate from any other basis for the recognition of judicial sales under any other bi-lateral or multi-lateral convention, instrument, agreement or principle of comity.

## 5 Analysis of the implications

5.1 If an international convention can prevent ships from being arrested unnecessarily, and international trade and maritime commerce from being disrupted then, it is submitted, a compelling need for such an instrument is clearly made out. Further examples, of the compelling need for the proposed convention will appear from the submissions made in the further information provided below.

5.2 There is currently no suitable international instrument that recognises the judicial sale of ships and the manner in which a competent sale of a ship should be carried out.

5.3 As a result problems have arisen, and will continue to arise, with regard to the arrest, attachment or detention of ships by debtors with claims arising prior to the judicial sale.

5.4 It is not considered that the proposal will have any major implications on cost to the maritime industry. Almost all jurisdictions already require some form of certification of a judicial sale, so this is unlikely to present an additional, or significant additional, burden on either the purchaser or the maritime administration.

5.5 The Checklist for identifying administrative requirements and burdens as set out in annex 4 of the *Guidelines on the Organization and Method of Work of the Legal Committee* (LEG.1/Circ.7) has been completed and is set out in annex 3 to this document.

## 6 Benefits



6.1 The recognition of foreign judicial sales will create certainty to innocent purchasers that they have clean title and can trade the vessel without disruption from debts that arose prior to judicial sale. Purchasers will be able to de-flag ships from the erstwhile owner's registry and re-flag them in a registry of their choice.

6.2 The innocent purchaser will be able to take title to its vessel secure in the knowledge that the validity of the judicial sale will not be challenged.

## **7 Industry standard**

7.1 There are no applicable industry standards. Three existing conventions bear mention, however.

7.2 The *International Convention on Maritime Liens and Mortgages, 1993* has not been successful as it contains controversial provisions which do not solve the problems of the recognition of foreign judicial sales, and the wording with respect to recognition is more in the nature of denying recognition, rather than granting recognition of the judicial sale. However, wherever possible, the draft convention has been prepared so that its provisions do not conflict with those set out in the *Maritime Liens and Mortgages Convention*.

7.3 Whilst the *International Convention Relating to the Arrest of Sea-going Ships, 1952* seeks to regulate the claims that can be enforced by the arrest of a vessel, it does not provide for the judicial sale of a ship.

7.4 The *International Convention on the Arrest of Ships, 1999* mentions the judicial or forced sale of ships, but only in the context of its article 3.3, allowing, as an exception to the general rule, the arrest of a ship owned by a person not liable for the claim.

## **8 Output**

### **8.1 Specific**

The draft convention addresses the specific issues and problems that had been encountered due to the non-recognition of foreign judicial sales.

### **8.2 Measureable**

The output is measurable with a view to the number of ratifications the new convention may achieve and hence, the number of judicial sales that will be covered by the convention.

### **8.3 Achievable**

The draft convention has already been prepared by the CMI through the considerable contribution of numerous National Maritime Law Associations and the convention has the sponsorship of two countries, 24 National Maritime Law Associations (this figure is likely to increase) and the CMI and it is reasonable to expect that, with the assistance of the IMO, it will be acceptable to a large number of countries.

### **8.4 Realistic**

Bearing in mind the support given to the draft convention thus far, it is submitted that the general acceptance of the draft convention is a realistic outcome.

### **8.5 Time-bound**

The development of the convention is time-bound and it will have specific entry into force conditions.

**9 Priority/urgency**

9.1 Issues arising in respect of the non-recognition of judicial sales are ongoing. Given the current depressed state of the shipping market, judicial sales are likely to increase over the foreseeable future.

9.2 It is therefore proposed that the development of the draft convention is added as a new output to the agenda of the Legal Committee.

**Action requested of the Legal Committee**

10 The Committee is invited to consider the proposal in this document and agree to add a new output to develop a new instrument on foreign judicial sales of ships and their recognition, and to take action as appropriate

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