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Bareboat ships under threat of auction in China

Innocent owners could lose their ships to court auctions over their charterers' disputes, under China's new maritime legal doctrine of 'if you can arrest it, you can auction it'

From 1st March, creditors can arrest ships over maritime claims against bareboat charterers and Chinese courts can order the arrested ships to be auctioned, even if the claims have nothing to do with the registered owner of the vessel.

That is the result of a fresh ruling by China's highest judicial organ, the Supreme People's Court (SPC). The ruling, officially known as a judicial interpretation, was issued over the weekend and took effect as of 1 March.

The ruling has become the object of hot discussion in Chinese shipping law and shipbroking circles and it threatens the vast fleet of Chinese lease-financed vessels no less than foreign financial owners.

Some observers defend the ruling as bringing Chinese practice more into line with international maritime law, which is the declared intention of SPC jurists.

"Now that the court has the power to sell the vessel, it makes it more attractive to arrest bareboat-chartered ships in China," said Shanghai-based Steffen Pedersen of Norwegian law firm Wikborg Rein.

"It was previously unclear what you could do after an arrest - the vessel would just sit there."

Others like Chen Xiangyong of Guangzhou-based maritime law firm Wang Jing & Co say the new Chinese rule lets claimants force sales without providing innocent head owners with protection.

"As the SPC now clarifies it, innocent head-owners cannot interrupt the sale, which means if the bareboat charterer has become insolvent and the arrested ship has to be sold following arrest, the usual protection given to head-owners by the non-lien clause and indemnity clause is of little significance, unless the charterer's obligation has been secured by way of a bank mortgage," said Chen, referring to clauses of standard forms such as Barecon 2001.

Chen says his firm is advising head owners and leasing companies to pay careful attention to the new judicial interpretation and make sure when drafting the charter that there are sufficient guarantees in place in the event vessels are sold for claims that arise during operations. Also during the charter period, he says, lessor owners will need to be alert to risks of arrest in China and make sure the bareboat charterer and its underwriters take responsibility for discharging the ship promptly.

Arrest for claims against the bareboat (not time or voyage) charterer was already permitted under Chinese maritime legal procedural rules but there was no well-established answer to the question about what courts can do with ships after they are arrested. The new ruling settles that issue according to the principle “if you can arrest it, you can auction it”, according to an authoritative summary of the matter published by the official Xinhua News Agency.

The ruling applies to both foreign and domestic owners and charterers but is especially striking in the light of the ongoing growth of the Chinese fleet of lease-finance players like ICBC Financial Leasing, Minsheng Financial Leasing and affiliates of numerous other Chinese banks as well as shipbuilders.

The new ruling touches on 25 separate issues related to ship arrests, including countersecurity, multiple arrest and the minimum price after two failed sales, which is now set at 50% of assessed value unless creditors with two-thirds of registered claims agree otherwise, and ships that do not attract the minimum price are released from arrest. The SPC directs courts to conduct their own auctions through a committee and do away with the practice of outsourcing to independent auction firms.

Chen points out that the decision leaves a number of other relevant issues unmentioned, including countersecurity under multiple arrest, whether a shipowner’s insolvency proceedings can interrupt ship arrest and judicial sale and override maritime lien and whether ships under construction can be arrested.

Mainland China is not a party to the International Convention on the Arrest of Ships of 1999 and, according to Supreme Court judge Luo Dongchuan, one of the main purposes of the new interpretation is to make clear China’s law on maritime arrest and auction in relation to international conventions. Luo spoke to Chinese journalists at a press conference on 28 February.

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