Judicial sales of ships in England and Singapore: latest developments

Introduction: judicial sales since the credit crunch
In hard times, ship finance lenders occasionally resort to arresting and foreclosing against their mortgaged assets through a court sale process. Fortunately such foreclosures have occurred infrequently since the present global economic downturn began in 2008. That is because lenders have, by and large, succeeded in restructuring their borrowers’ debts or have otherwise persuaded them to conduct an orderly asset disposal process involving the private sale of their ships through brokers.

It has also helped that credit remains tight in all sectors, such that ships do not tend to be heavily encumbered with trade debts, be it for bunker supplies, port agents’ charges or repair costs. Therefore, mortgagees have not usually had to move quickly to foreclose before other maritime creditors step in to do so.

Further, insolvent ship owners have tended to co-operate responsibly to wind down their businesses save where, in a few well-publicised cases, they have resorted to insolvency regimes, such as Chapter 11 in the USA, to resist foreclosure by appealing directly to a court sanctioned ‘corporate rescue’ process.

Occasionally, however, there is no appetite for a costly insolvency process whose outcome is inevitable and yet an orderly sale process is also difficult to achieve given the high level of trade debts and potential maritime lien claims which might survive a private ‘MOA’ sale. In these cases, lenders, on occasion, arrest and apply for the judicial sale of their mortgaged assets. When they do so, they prefer to do so in legal jurisdictions which favour their interests.

Why English jurisdictions offer the best solution for mortgagees
English common law systems, particularly those of England itself, Gibraltar, Hong Kong and Singapore, have all carved out an enviable reputation as the foreclosure jurisdictions of choice for lenders. That is...
because (i) the sale process is very quick, and therefore cost effective, (ii) the priority ranking system favours the mortgagee, with the class of maritime liens being limited and (iii) the law is both certain and applied by specialist, Admiralty judges.

The key cost determinant is the time it takes from arrest to sale, during which time (i) the mortgagee will, typically, be funding operational costs including, in particular, crew wages, insurance, bunkering and berthing charges and (ii) the ship will be under detention and not earning. In many jurisdictions, typically the non-common law jurisdictions with codified civil procedures (including France, Italy, Spain, Portugal, Germany and most of their former colonies), this process can take many months, and even years. That can fundamentally alter the economics of a foreclosure exercise and reduce a mortgagee’s recovery to as little as nothing. Cases of mortgagees deciding to abandon their security in such cases are not unknown.

The attraction of a ‘direct’ judicial sale without auction

English lawyers have long advised their clients that the time period between arrest and sale can be reduced even further if the mortgagee applies to the court to approve a ‘direct’ sale, without the need for an auction, to a specific buyer (often another customer of the mortgagee whom the mortgagee finances to purchase the ship). This can reduce the time from arrest to sale from 6-8 weeks to as little as 1-2 weeks. Use of this process obviously depends on the ship either trading to such a jurisdiction so that it can be arrested there or the ship owner acceding to its lender’s request to sail the mortgaged ship(s) to such a jurisdiction for arrest and sale.

Until now, the majority of judicial sales in England have been direct sales to a specific buyer (financed, typically, by the mortgagee), for a specific price (as contemplated in the notes to Part 61.10 of the Civil Procedure Rules 1999 contained in the court’s White Book), without physical appraisement (by a surveyor appointed by the Admiralty Marshal) and without either advertisement to invite bids or auction. Such sales have been given various names, from fast track or ‘quickie’ sales to ‘ex parte’ or ‘private treaty’ sales, the private treaty in such cases being with the court, rather than the owners or the mortgagee. Not only did such sales save lenders US$100,000s in operating expenses, but they also avoided liability for the court appointed brokers’ fees (usually 1% of the purchase price). Court sales without auction accounted for 23 of 31 mortgagee sales in England in 1999-2000.

In England, the Admiralty Marshal has for many years had the flexibility to sell either by auction or by private treaty (see e.g. The Everilda [1927] Lloyd’s Rep. Vol. 29, p. 238). When the court orders the direct sale of a ship without auction, the Admiralty Marshal’s bill of sale delivers the ship to that purchaser free of pre-existing liens and encumbrances, in the same way as if the arrested ship had been sold through public auction.

To avoid an auction, the mortgagee usually had to satisfy the court that the intended purchaser was unrelated to the Defendant owner and the sale was for a purchase price at least as high as a “willing seller, willing buyer” price for the ship if sold on the open market. Mortgagees were often amenable to financing above market purchases as it permitted them to roll forward all or a substantial part of the old borrower’s loan debt (which, typically, exceeded the ship’s open market value) into a new loan to the purchaser. To support its application, the mortgagee would adduce in evidence two or more desk valuations from reputable S&P brokers to support the price offered. The court was receptive to such applications on the basis that judicial auctions tend to achieve depressed ‘forced sale’ prices, such that a sale for a full market price without the need for an auction benefitted all maritime claimants by swelling the fund and reducing priority arrest and sale costs.
Doubts as to the ‘direct’ sale process

Not all English common law courts have adopted this approach. In Hong Kong, for example, as long ago as 1998 the court held in the “The Margo L” [1998] 1 HKC 217 that there must exist “powerful special features” to justify such an order. For example, if there were cargo onboard which the purchaser was prepared to deliver, thereby avoiding prohibitive discharge costs being incurred and claimed against the sale proceeds, this might suffice. The Margo L decision was rumoured to have been made after the then Hong Kong Admiralty judge, Mr Justice Waung, was incensed to read in the trade press that a ship, whose direct sale he had just ordered, had been on-sold for a higher price. That too was probably a case of a bank rolling forward debt through an above market sale, but it sufficed to end direct sales in that jurisdiction.

More recently, in Singapore, Mrs Justice Belinda Ang has, this year, rejected at least two applications for direct sales, and ordered an auction. A written judgment setting out the judge’s reasons for rejecting the applications is expected shortly. In cases where other maritime creditors oppose a direct sale, it is also almost inevitable that the court will order an auction as the only certain way to determine which sale method will achieve the best price.

In the latest development, the Admiralty Judge in England, Mr Justice Teare, ruled, in Bank of Scotland Plc v Owners of the Union Gold [2013] EWHC 1696 (Admlty), that a judicial sale will only be ordered to a direct buyer without appraisement and auction if there are ‘special circumstances’ to justify such an order. An example of ‘special circumstances’ given by the judge would be where it were shown that a delay in the sale would cause the loss of a particularly valuable employment fixture.

It is likely that the Gibrallar courts would now follow the Union Gold decision, especially if an application for a direct sale were challenged.

Unfortunately, banks and their legal advisors may, over the years, have become rather too complacent about such applications. The court has always been concerned to obtain the highest price for a ship and any applicant for a court sale is unwise to forget this. In some cases, it is relatively straightforward to identify a ship’s open market value, by reference to recent, comparable sales. In others, it is not so simple. In the Union Gold case, which concerned four small cargo ships, the Admiralty Marshal’s own brokers acknowledged that they had little experience of valuing ships of this kind. Further, the various brokers’ valuations obtained by the bank varied quite considerably. Further, the judge expressed doubt that a court auction would realise a lower price than a private sale through brokers, given that the court could give the purchaser title free of liens and encumbrances, unlike a ship owner, especially one in financial difficulty. The judge also noted that, where a bank sold a ship under its ‘power of sale’ contained in its mortgage, it would usually be unwilling to give the purchaser any warranty that the ship was free of liens and encumbrances.

Ultimately, the judge was unconvinced that the cost of the short delay involved in appraisement and advertising an auction outweighed the risk of a ‘direct’ sale not achieving the best possible price. The judge relied on dicta in a number of older cases which emphasised that (i) the Admiralty Marshal should decide the timing of an auction (The Halcyon the Great (No 2) [1975] 1 Lloyd’s Rep. 525) even if this meant further costs being incurred to maintain the ship and (ii) the court disapproved of parties marketing ships for private sale, even if done under the Admiralty Marshal’s supervision, once an order for appraisement and sale had been made (The AP Shalin [1991] 2 Lloyd’s Rep. 62).
The judge was less perturbed that the bank intended to finance a newco owned by the former managing director of the defaulting borrower to purchase one of the four ships. That was the only direct sale which the judge ordered, given that there was evidence, in that case, that the ship would lose a valuable employment contract if it were not promptly sold.

**Conclusion: will the Union Gold decision have much practical impact?**

We do not consider that the *Union Gold* decision (or the decisions of the judge in Singapore) will have much practical impact or undermine England and Singapore’s competitive edge for court sales.

In practice, where a mortgagee arrests a ship, the process of identifying and agreeing a financing package with a potential purchaser, and of replacing or re-engaging the crew and conducting repairs to make the ship ready for future trading takes at least 2–4 weeks, and often rather longer, such that an auction can usually be applied for and held concurrently with such behind the scenes negotiations, with no overall loss of time. That aside, in many cases, lenders or lending syndicate members are exiting the shipping market and are content to use an auction process to realise their security, rather than to finance a new owner to purchase the ship.

A court sale by auction in England can still take place in as little as a month or so after arrest, provided the owner co-operates. Maintenance costs can be minimised by laying up the ship, for example in the river Fal in Cornwall, and retaining only a skeleton crew. In those rare cases where the loss of this time will seriously impact on a ship’s earnings, the ‘direct’ sale route still remains permitted, if evidence to this effect is presented to the court.

*Should you wish to discuss any of the matters raised in this briefing, please speak with one of the authors, Charles Buss and Mark Tan, another member of our team below, or your regular contact at Watson, Farley & Williams.*

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