

**THE ROLE OF SHIP AND MORTGAGE REGISTRATION  
IN SHIPPING FINANCE:  
the prospects for the Russian Federation**



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## **1 Introduction**

The objective of this thesis is to provide an analysis of the current issues and conditions affecting shipping finance in Russia based on the development of the systems of ship and mortgage registration.

Particular economic reasons describing the situation on the shipping markets lie outside the scope of this thesis. However, a general overview of the situation of the shipping markets and results achieved by the leading banks will be provided in the first chapter. The reason is to demonstrate that in spite of a business recession in some areas, shipping companies continue to experience favourable market conditions such as the increased freight rates and the continuing demand for gross tonnage capacity. The latter has led to the companies expanding or upgrading existing vessels.

Another reason for choosing the above subject was the experience obtained working in the shipping finance group of a City of London law firm during the last 9 months. The author was involved as an assistant in a number of loan facility transactions for financing newbuildings for the Russian-controlled borrowers. Analysing the structure of the transactions it was noted that mortgage over the vessels and vessel registration in one of the open ship registries were prerequisites of the lending banks.

In this thesis the following issues are to be considered:

- (i) the role of mortgage over the vessel as one of the securities in a shipping finance transaction;

(ii) the role of underlying vessel registration and advantages and/or disadvantages of the existing types of ship registries;

(iii) the procedures for ship and mortgage registration under Russian law and

(iv) an analysis of the relative advantages and disadvantages of the Russian mortgage.

In order to integrate the above issues, the following structure and terminology will be used in this thesis:

(a) overview of shipping finance based on the results of the shipping banks survey published (chapter 2);

(b) analysis of shipping finance characteristics, sources and main types of securitisation in shipping finance (chapter 2);

(c) current issues in relation to ship and mortgage registration (chapter 3);

(d) research on provisions of the ship and mortgage registration under Russian law (chapter 4); and

(e) comparison between requirements in connection with

(i) ship registration in the Russian International Ship Registry and Norwegian International Ship Registry.

The research is based on the textbooks and relevant legislation as well as conference papers obtained from recent conferences held in Saint-Petersburg, Russia and made available to the author during the course of preparing this thesis and professional experience in the registration of ships and ship mortgages.

## 2 Ship Finance Today

### 2.1 Shipping Banker Survey

The annual Shipping Banker Survey carried out by Marine Money<sup>1</sup> revealed its results in May 2008. Fortunately, the shipping markets held strong during the credit crunch started last year with American home mortgage defaults and damage within the shipping industry itself has thus far been minimal. The vast majority of banks met high return targets, most grew their portfolios over the past year and intend to continue to do so in the coming months.

According to the above-mentioned survey, 89.4% of the respondents anonymously confirmed they were able to meet their return on equity targets. Figure 1 shows how this number compares to past years. While a declining trend can be seen, the reality is it's just over three percentage points lower than the high success rate reported by the same group of respondents in 2004.

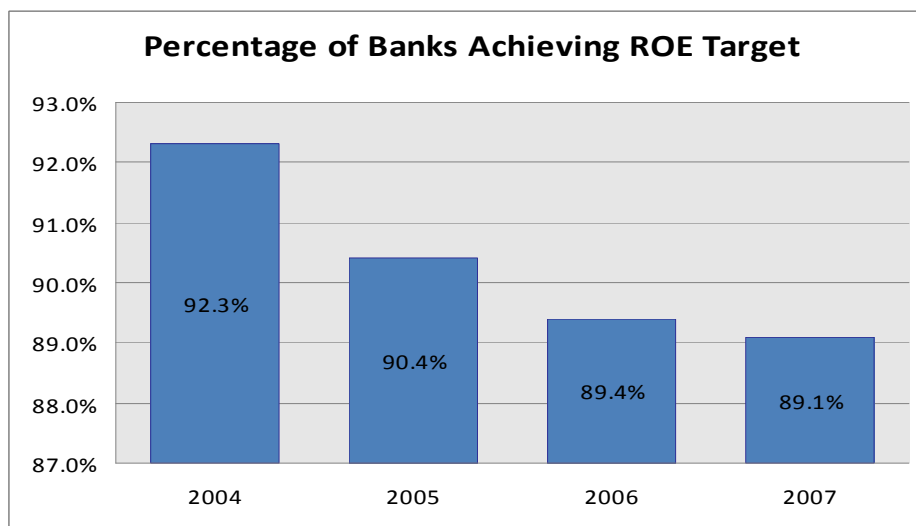


Figure 1

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<sup>1</sup> Nora Huvane. *The 2008 Shipping Banker Survey*. In: Marine Money. *The Ship Finance Publication of Record*. Vol. 24 (2008), pp. 2-9.

Since numbers convey more than words in this instance, Dealogic have prepared and published their annual Ship Loan League table <sup>2</sup>. Figure 2 shows the top 10 banks in shipping finance and their results for the period from January to December 2007.

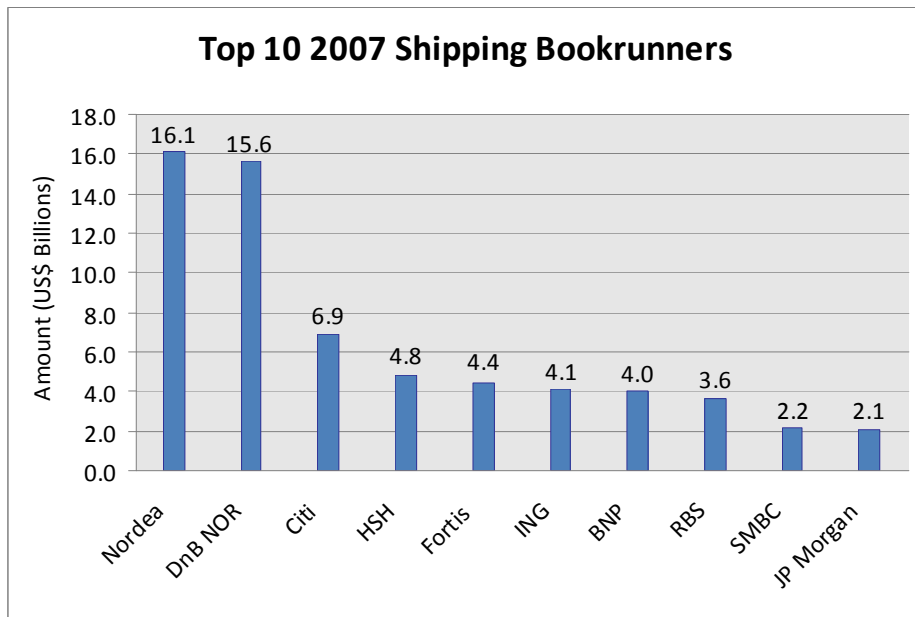


Figure 2

Ship prices have reached all-time highs. Quite extraordinary freight fixtures were being achieved: a VLCC approaching US\$300,000 a day, bulkers - at US\$200,000 a day. Shipyards around the world have full order books for several years ahead, with ships frequently changing hands while still under construction. The whole order book represents 62% of the existing fleet. And the maritime expansion to the Arctic has not yet started.

On the other hand, the shipping industry has not been absolutely immune from the turmoil in the global financial markets. Fortunately, not all the banks have been

<sup>2</sup> Ship Loan League table by Dealogic. In: *Shipping Finance. Review 2008/2009* (Euromoney yearbooks), p.115.

affected by the credit crunch but the banks became more careful in their approach to risk and this includes documentary and transactional risk as well as credit risk.

## 2.2 Shipping Finance Characteristics

Shipping finance is an asset-based finance. There are four characteristics that make shipping finance distinctive <sup>3</sup>:

- (i) capital intensity;
- (ii) mobility of assets;
- (iii) volatility; and
- (iv) business structure

Capital intensity means that the amounts borrowed are large, not only in absolute terms but also as a percentage of total asset value. It is very rare that a company could afford a ship-based transaction without borrowing required capital from any financial institution.

Mobility of assets means that ship finance is international. Most ships move all over the world. Ships trade in a perilous environment and move continually from one jurisdiction to another. Lenders tend to treat ships as "stand along" assets with wide swings in value that occur.

Volatility means that the shipping industry is exposed to volatile and unpredictable market conditions that frequently experience wild swings in revenues and asset values. All industries face economic risk, but some of the risks in shipping are unique to the industry.

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<sup>3</sup> *Shipping Finance*. Prepared by Stephenson Harwood. Third edition. Euromoney Books. 2006. p. 71.



Business structure in our case means that the industry is dominated by entrepreneurs. Most ships are owned through single purpose companies incorporated in a country in which the ship is to be registered or in one of its tax favorable off-shore jurisdictions.

### 2.3 Sources of Shipping Finance

Typically, ship finance is carried out in two parts: the ship owner putting up a certain percentage of the vessel's cost from their own capital, and the bank providing the balance of the necessary capital, secured by a mortgage over the vessel.

Shipping was traditionally a bilateral business, but over the years there has been a greater and greater volume of syndicated loans. A syndicated loan is one made to the same borrower on the same terms but by more than one bank, coordinated by an arranger/agent and a book runner, with syndicate members agreeing to share payments made by the borrower.

There are three main groups of sources of shipping finance:

- (i) equity finance;
- (ii) mezzanine finance; and
- (iii) debt finance

Equity finance is the form of finance where shareholders put up risk capital in return for the prospect of dividend payments and capital growth on their shares; dividends are paid out of the company's taxed income. A company could be financed either private or public.

Debt finance also called debt funding occurs when bank lends money to the borrower and, in return for using the loan, the borrower pays the bank the principal amount of the debt together with interest on it. Interests may be paid at the end of each agreed period or in one when the loan matures.

Mezzanine finance lies between pure equity and senior debt (loans that rank ahead of other debt and shareholders on a company's insolvency). This type of finance gives lender the option of turning its loan (or part of the loan) into shares if company goes well. In return, its lending ranks behind senior debt.

Leasing structure can also be used between a bank and a shipping company to finance a new-build vessel. Although it is more difficult to discuss the role of mortgage as a security in lease transaction since the bank could be acting as lessor and, in this case, would hold the title to the vessel.

More complicated structures could be established but the author does not have the relevant experience to discuss them.

#### 2.4 Securitisation in Shipping Finance

Irrespective of the nationality of the parties, a large number of loan agreements in international shipping are expressly governed by English law. Similarly, most security documents will be governed by English law. There are, however, some exceptions in respect of the ships mortgages which in most cases will be governed by the law of the ship flag.

Traditionally, securities for a particular loan facility will be discussed between the bank and the borrower during their negotiation of the term sheet. Term sheet is a document the main purpose of which once signed is to confirm commitment of the parties to enter into the transaction and to set out the principal terms and

conditions (such as loan amount, loan term, covenants, conditions precedent, securities etc.).

The principal types of security for a ship-based transaction are<sup>4</sup>:

(i) first priority mortgage over the ship concerned – will be discussed in the following chapter;

(ii) an assignment of all the insurances of that ship – means all benefits from all policies and contracts of insurance entered into between the borrower and hull and machinery and war risks insurer and protection and indemnity associations will be paid directly to the bank towards payment of outstanding debt;

(iii) an assignment of all the earnings of the ship, possibly including a specific assignment of a particular charterparty – means all hires, freights, remuneration for salvage and towage services, demurrage, contribution in general average and other sums payable to the borrower;

(iv) an assignment of any requisition compensation of the ship – all money payable to the borrower as a result of the vessel being requisitioned, expropriated, confiscated by any state;

(v) a guarantee and indemnity, usually from parent company or ultimate beneficial owner of the borrower - without them banks lose any recourse to those behind the shipowning company;

(vi) a charge or a pledge of the shares in the borrowing company; and

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<sup>4</sup> *Shipping Finance*. Prepared by Stephenson Harwood. Third edition. Euromoney Books. 2006. p. 31.

(vii) security over earnings and retention accounts – at least in theory the bank will have control over the company's cash flow.

Each particular transaction will be represented by individual combination of the above securities. It should be noted that this list is by no means exhaustive.

The scope of this thesis does not allow discussing in details each of the abovementioned type of securities.

The ultimate aim must be to give the bank maximum protection consistent with allowing the borrower to operate his business and maximize his earning capacity without undue restraint.

### **3 Ship and Mortgage Registration**

#### **3.1 Ship registration**

The freedom of the high seas is one of the fundamental principles of public international law and the principal reason for registration of a ship is to provide the ship with a jurisdiction so that she can enjoy the freedom of the high seas giving the ship unrestricted access to all parts of the sea not included in the territorial seas or internal waters of a state.

In order that such unrestricted access should not lead to a situation of anarchy or abuse, international law lays down a number of rules providing a framework for the exercise of that freedom and looks to the vessel's flag state to ensure compliance with such rules.

As a result of their mobility, international law requires that ships comply with appropriate technical and operational standards, particularly with respect to crewing, safety and increasingly environmental protection by registering with a recognised ship registry or flag state. It is important to note that a vessel can only be registered with one flag state at any given time, although this is subject to one exception stated in paragraph (d) below.

The flag state will then exercise its jurisdiction or control in administrative, technical and social matters over ships flying its flag and take such measures as are necessary to ensure safety at sea.

Therefore a flag state must prohibit its vessels from sailing except in compliance with international rules and standards, ensure its vessels carry the necessary certificates and periodically inspect vessels registered with it. A flag state must also investigate any violation of international rules and standards and penalise any such violations.

A stateless ship enjoys no protection in international law. If a ship cannot provide evidence that she is registered and subject to the jurisdiction of a state it will not be able to engage in lawful trade as she will not be allowed to enter any port or a port state can detain a ship if she does not have the relevant registration and trading and safety documentation. Therefore if a ship is not registered or is insufficiently registered it will not be able to trade freely, will be liable to seizure and detention and the insurance cover will not be valid.

There are three principal types of flag namely:

(a) flags of convenience/open registries

The origin of flag of convenience has its roots in the ingenuity of British merchants in the 16th century, who used the Spanish flag to avoid Spanish monopoly restrictions on trade with the West Indies, and later of British fishermen in the 17<sup>th</sup> to 19<sup>th</sup> centuries, who tried to avoid fishing restrictions imposed by Great Britain by using either the French or the Norwegian flags<sup>5</sup>.

These are flags available to ships that are beneficially owned and crewed by persons other than the nationals of those countries whose flag the ship flies. Important flags of convenience include Panama, Liberia, Marshall Islands, Malta, Cyprus and the Bahamas, with which the overwhelming majority of the world's tonnage is currently registered.

The characteristics that distinguish some, but not all of them, from national registries include:

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<sup>5</sup> Aleka Mandaraka-Sheppard. *Modern Maritime Law and Risk Management*. Second Edition. Routledge Cavendish. 2007, p. 278.

(i) the ships are owned and/or controlled by non-citizens of the country in question;

Although in some countries e.g. Cyprus it is necessary to establish an owning company in the jurisdiction. However this is generally a very straightforward procedure necessitating the purchase of an offshore company which is run through nominee directors and, if necessary, nominee shareholders;

(ii) no local income tax on the ship's earnings; however owners will have to pay ongoing annual or tonnage taxes, and registration fees but usually no other fees will be charged;

(iii) no restrictions on the manning or nationality of the crew of the ship (crew costs are owners' biggest expense and open registry requirements often mean that low cost crew can be employed);

(iv) anonymity, the ship may be the only asset the company owns with the company being represented by bearer rather than registered shares and the directors of the company by nominee directors therefore it is virtually impossible to trace the beneficial ownership in these circumstances; and

(v) straightforward registration procedures and easy access to the ship registry, for example, the ship registry may have a number of consuls abroad such as Panama and Liberia.

(b) International flags

These are one of the ways in which countries have tried to attract tonnage back from the open registries. An owner may prefer to register its ships under one of the

international flags such as the Norwegian, French, Danish and German International Ship Registers or offshore flags such as Isle of Man and Hong Kong. These are designed to offer an owner some of the benefits of a flag of convenience such as less stringent requirements for ownership and crew nationality, while retaining some linkage between the beneficial ownership or management of the ship and the underlying flag state.

(c) National flags

The traditional maritime nations typically require there to be a genuine link between the state and the ship. For a ship to be eligible for registration under a national flag, ownership qualifications must be fulfilled (usually the ship has to be wholly owned or at least 75% owned by its nationals) (either individuals or companies), she must be managed or controlled from within the country of the flag she flies and the ship must meet certain operational standards.

Therefore when an owner is considering where to register its vessel, it will also need to consider whether or not its chosen flag will be acceptable to a lending bank. Typically banks do not see the flag in isolation from the quality of the owner and their security, it is an important factor for a bank's credit committee to consider.

Typical documents required by a ship registry will include:

- (i) a bill of sale (which is the document transferring ownership/legal title in the vessel);
- (ii) a declaration of ownership;
- (iii) appointment of authorised officer;
- (iv) a tonnage certificate;
- (v) evidence issued by the vessel's previous registry that she is free from encumbrances; and



(vi) evidence of seaworthiness and certificates issued by the vessel's previous registry or class society.

In many cases registration is a two stage process.

First, the ship is provisionally registered in the chosen registry; and second, subject to the delivery of additional documents (usually within a specified time frame) (e.g. a deletion certificate from the previous flag), provisional registration will be converted into permanent registration.

#### (d) Bareboat registration

Bareboat registration is a system of parallel registration or dual registration of ships. The basis of this registration is the suspension or temporary cancellation of the ship's primary flag state for the duration of a bareboat charterparty. This then entitles the ship to fly the flag of another country i.e. in which the bareboat charter registry is based and means that a vessel registered in one state is actually permitted to fly the flag of a second state for a determinate period.

Not all registries permit bareboat charter registration but an increasing number do for example Liberia, Panama, Bahamas, Germany, St. Vincent & Grenadines, the Russian Federation, Cyprus and the UK. Registration is entirely dependent on the compatibility of the two legal systems concerned i.e. the primary registry and the ship's incoming bareboat registry.

There are a number of advantages for an owner effecting dual registration:

(i) it can reduce crew costs by flagging into a state with a low wage economy such as the Philippines; and

(ii) the gaining of access to waterways or a particular cargo trade that would not be possible under the ship's primary flag.

### 3.2 Mortgage registration

A mortgage is a transfer of property or an interest in property as security for a debt. However, the transfer is not absolute as it is subject to a right of redemption as such transfer is made by way of security only. The purpose of the ship mortgage is to enable the lender, upon the occurrence of an event of default under a loan agreement, to enforce its claim against the ship, as well as the shipowner. The lender needs to be able to take possession of a ship and sell the ship in order to realise funds from the sale, which hopefully will be sufficient to satisfy the loan due from the shipowner.

This in rem right against the ship is enforceable by the courts throughout the world and gives the lender priority over unsecured creditors of the ship and her owners (except for maritime liens) provided the bank has a duly constituted and registered mortgage.

In order to obtain a legal, valid and enforceable mortgage it is necessary to satisfy all of the requirements for the creation of a mortgage laid down by the law of the flag state of the ship. It is important that the mortgage is recognised as a valid security against third parties and for this a mortgage, unlike a maritime lien, must be registered, with appropriate priority, on the relevant ship's register and, if required must be registered in the prescribed form.

Not all ship registries have a prescribed form of mortgage. Certain flag states such as Panama or Liberia do not have a specified form which the ship mortgage must

follow, these mortgages are known as preferred mortgages. Whilst registries, such as the UK, Cyprus, Bahamas, Malta and Hong Kong have a prescribed statutory mortgage form which must be completed and registered in the form provided, these mortgages are known as priority mortgages rather than preferred mortgages. The preferred form of mortgage is usually a much longer document than the statutory form of ship mortgage as it contains all the owner's covenants to the bank concerning insurance and maintenance of the vessel and will also set out the bank's powers in the event of an enforcement. As the statutory mortgage is a short document which just contains the actual charge or mortgage over the ship a separate collateral deed of covenants will be taken in addition to the statutory ship mortgage which will also contain provisions concerning insurance, maintenance of the vessel and cover enforcement powers and procedures.

Registration of the mortgage gives notice to any prospective purchaser or other party having dealings with the ship of the existence of the mortgage. If a prospective purchaser searches the ship register and discovers a mortgage registered against the ship he will have to ensure that arrangements are made for the discharge of the mortgage, so that he can obtain registration in his name free of mortgage. The consequences of failing to register a mortgage are usually that the security is lost and the mortgage will be unenforceable against third parties, and priority will be lost to a later in time registered mortgage. Failure to register may also mean that any priority is lost in a court sale of the ship and as a consequence the bank may not receive the proceeds of sale upon distribution by the court.

(i) Priority

In the vast majority of jurisdictions such as UK, Bahamas, Malta, Cyprus, Singapore, Hong Kong mortgages take their priority from the date and time of registration and not by date of execution of the mortgage itself. Still it is always important to get

advice in the jurisdiction concerned as regards to priority and formalities to be observed.

Theoretically there is no limit to the number of mortgages that can be registered against one ship. However if the value of the ship is less than the debt secured by the preceding registered mortgages, the value of any subsequent mortgages is effectively "nil". However when a prior registered mortgage is discharged, any subsequent mortgages will effectively rise in priority and can have value as a result.

As a general point, if a subsequent mortgage is to be registered most registries require the prior registered banks to give their written consent to the subsequent mortgage.

#### (ii) Maritime Liens

These are claims against the vessel which will follow the ship notwithstanding a change of ownership. They can only be discharged by a court sale. Certain maritime claims will rank ahead of a mortgage regardless of whether they arose before or after the date the mortgage was created. The following claims are usually recognised as claims giving rise to a maritime lien ranking ahead of a mortgage:

- (a) salvage/collision;
- (b) crew claims;
- (c) costs of an arresting creditor; and
- (iv) master's disbursements.

Different jurisdictions will have different laws as regards what constitutes a maritime lien and whether or not this will have priority over a mortgage therefore advice in the relevant jurisdiction should always be sought.

(iii) Mortgage over bareboat registered vessel

From a bank's perspective the above can make financing more viable. However, a bank will need to ensure his interests are fully protected since if a vessel is dual registered, the bank's mortgage in the primary registry will remain registered with that registry and cannot usually be transferred to the secondary or bareboat registry. Sometimes it may be possible to register a mortgage or the bank's interest in the secondary or bareboat registry but this is usually not the case and so advice should always be sought in the relevant jurisdiction.

Where possible the bank will need to ensure that the bareboat registry records the fact that the vessel is subject to a mortgage in its primary registry so that third parties are put on notice of the existence of the mortgage in the vessel's primary registry. Therefore if a vessel is dual registered in order for a bank to be able to enforce its mortgage it will need to terminate the bareboat registration and the registration under the second flag and revive the vessel's primary registration (since in certain flag states the primary flag state's registration will be cancelled altogether whilst the vessel is flying another flag).

In order to revive the primary registry applications will need to be made to the vessel's bareboat registry to terminate the bareboat charter and bareboat registry. So that a bank can ensure that it can do this even without the owner's and charterer's co-operation it will usually obtain undated letters of termination and powers of attorney from the owners and charterers up front which it can subsequently put into effect if there is an event of default. However, advice must be sought from the relevant jurisdiction in order to find out (i) exactly what documents and procedures are required to terminate the secondary registration and whether these can be obtained in advance whilst the owners and charterers co-operation is available and (ii) what is required to revive or restore the Vessel's

primary registration so that the bank can enforce its mortgage in the event of a default.

(iv) Discharge of Mortgage

When the bank's loan has been repaid in full (or alternatively the ship is being sold or the loan is being refinanced by another bank) the mortgage will need to be discharged. Most mortgages/deeds of covenant contain an undertaking that when this happens the mortgage will be discharged by the bank, usually at the request and expense of the owner. If the mortgage is in the statutory form the bank will need to complete the discharge on the reverse of the original registered mortgage i.e. British, Cyprus, Bahamas or Malta. If the mortgage is of the preferred form then the bank will usually complete a "Certificate of Satisfaction of Mortgage" i.e. Panama or Liberia. This will generally identify the ship, the bank and the borrower and include the recording data of the original mortgage. In either case the discharge needs to be registered at the relevant ship's registry to enable a clean transcript or certificate of ownership and freedom from encumbrances will be issued.

## **4 Ship and Mortgage Registrtrion under Russian Law**

### 4.1 Ship registration

#### (a) Ship registries and underlying legislation

At the beginning of 2008, vessels registered in the Russian Federation reached 3,481 in number with a total deadweight of 7,587,283 tonnes<sup>6</sup>. At the same time the number of ships registered in the International Ship Register reached nearly 200 with a total deadweight of approaching 900,000 tonnes.

The registration of Russian ships is governed by the following legislation consisting of:

- (i) The Merchant Shipping Code of the Russian Federation;
- (ii) The Law on Amendments to Particular Legislative Acts of the Russian Federation for the Formation of the Russian International Ship Register dated 20.12.2005 No.168-FZ;
- (iii) The Rules of Registration of Ships and Titles to Them in Merchant Sea Ports established by the Ministry of Transport of the Russian Federation on 21 July 2006 No.87 in accordance with Articles 5 and 33 of the Merchant Shipping Code; and
- (iv) The Rules of Registration of the Fishing Fleet Vessels and Rights to Them in Fishing Seaports;

According to Article 33 of the Merchant Shipping Code, a vessel may be registered with one of the following registers:-

- State Ship Register;

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<sup>6</sup> Source: Lloyd's Register – Fairplay, World Fleet Statistics 2007 published in In: *Shipping Finance. Review 2008/2009* (Euromoney yearbooks), p.124.

- Russian International Ship Register;
- Bareboat Charter Register;
- Ship's Book (for leisure and sport vessels and also for self-propelled vessels with main engines at less than 55 kW power and non self-propelled vessels of less than 80 tons); and
- Register of Vessels under Construction (which is incorporated into the State Ship Registry).

According to Article 12 of the Merchant Shipping Code of the Russian Federation a vessel to be registered under Russian flag can be owned by either a Russian citizen or a legal entity incorporated in the Russian Federation, the Russian Federation, subject of the Russian Federation or municipality. There are qualifications as regards some of the Registry requirements. For example nuclear-powered vessels can be only owned by the Russian Federation.

Only vessels that are to be used in international carriage of goods, passengers and their luggage and in other kind of international trade can be entered on the Russian International Ship Register.

The initial move to the Russian International Ship Register established in 2005 came from the river/sea fleet with an average deadweight of 4,500 tonnes. The average age of vessels registered with the Russian International Ship Register is 23 years. This is broken down as follows:

- (i) aged 5 or less years – 14 vessels;
- (ii) aged 5 to 15 years – 8 vessels;
- (iii) aged 16 to 25 years – 97 vessels;
- (iv) aged more than 25 years – 78 vessels.



The Russian ship registration system is not centralised but carried out at individual ports. The Ministry of Transport has approved 43 Seaports for the purpose of registration of the sea vessels with the State Ship Register, Bareboat Register or the Register of Vessels under Construction and 12 of them are further designated as the Seaports where a vessel may be registered in the Russian International Ship Register.

According to the Rules of Registrations of Ships, the State Ship Register, the Bareboat Register, the Register of Vessels under Construction and the Russian International Ship Register are all kept by the Harbour Master of a particular seaport and are part of the relevant unified registers.

(b) Title registration

According to the Article 130 of the Civil Code of the Russian Federation, sea-going vessels and inland waterway navigation vessels are considered “immovable property” and subject to state registration. Further paragraph 3 of Article 33 of the Merchant Shipping Code states that registration of a vessel, the right of ownership or other property rights to that vessel, as well as restrictions or encumbrances of the rights to that vessel in the State Register of Ships, Russian International Ship Register or the Ship's book, shall be deemed sole evidence of the existence of the registered right of ownership which may be challenged only in court proceedings in the Russian Federation. Therefore the registration of a Russian ship is conclusive evidence that the registered owner is the true legal owner of the vessel and the registration of a mortgage in the same register is conclusive evidence of the encumbrance over that vessel under Russian law. As of 30 August 2007 152 mortgages had been registered in the above Russian Registers with 4 of the 28 banks being foreign banks. In general, every fourth vessel registered under the Russian flag is currently mortgaged.

The importance of the entries on the relevant register is therefore obvious. Russian ship registration system is not centralised but carried out at individual ports. The

registers of ships are open for any person interested in obtaining information contained in them. However one cannot simply walk into a Harbour Master's office and demand to inspect his registers. One must first make a request of the Harbour Master. In order to make a request, the person shall present proof of identity and registry extract application. A company shall provide confirmation of its state registration and authority of a person performing the request. Requested information shall be provided within 5 days. The fee be payable according to the tariff approved by the Government of the Russian Federation. There is no fee applicable for request for an extract from the register. The extract from the register shall contain information about the vessel, registered rights and encumbrances. The registered owner of the vessel, in his turn, is entitled to receive information about all requests performed in respect of the vessel.

Each request should be made to the particular port where the vessel is registered or known to be registered in order to get an extract from any of the registers. The situation is that there is no unified record system or data base in respect of any ship register in Russia. For example, if the vessel is registered in Vladivostok Sea Port there would be no record about this vessel in any other sea port on the territory of the Russian Federation.

(c) The role of the Harbour Master

The International Harbour Master's Association ([www.harbourmaster.org](http://www.harbourmaster.org), last visited in March 2008) recently conducted a worldwide survey to identify the duties and functions of a harbour master. Forty functions were listed and every function was performed by at least one of those harbour masters consulted. However, there are only five functions listed that everyone who responded to the questionnaire carried out. This exercise revealed the range and diversity of the responsibilities that are imposed on those who perform the harbour mastering role. These variations in the job description are not merely explained by differing national traditions and structures, since large variations can exist within one country.

Factors such as the port's size, its specific function and how it is owned and administered will also make a difference.

The IHMA definition of a harbour master is:

"a harbour master is that person who, whatever may be his local title of office, is the principal person who normally exercises jurisdiction at a place and in ways that meet the following criteria:

- That the jurisdiction is exercised over the water area of a port of approach;
- That in the exercise of this jurisdiction he should possess an authority conferred on him by national law, regulation or rules;
- That the duties should encompass a legal and/or operational responsibility for the movement of shipping; and
- That the duties should involve him significantly in ensuring that shipping movements within the area of jurisdiction are carried out safely.

The status of a Harbour Master of a Russian seaport is governed by the Merchant Shipping Code, Federal law No.155 on Inland Sea Waters, Territorial Waters and Contiguous Zone of the Russian Federation dated 31 July 1998, the Ministry of Transport Regulations on the Harbour Master of the Seaport approved on 19 December 2006 and the most recent Federal Law No. 261- FZ on Sea Ports in the Russian Federation dated 8 November 2007.

The new Law on Sea Ports in Russia has a provision on the status of the Harbour Master according to which "The Harbour Master heads seaport administration, being an official exercising functions regarding the registration of vessels and release of vessel documents, registration of vessel ownership and mortgage, ensuring safe navigation and order in a seaport. The Harbour Master shall have higher education in navigation and a diploma confirming his right to be a master of a ship with a gross tonnage of 3,000 tonnes and higher."

A Harbour Master of a fishing port shall coordinate his actions with those of the Harbour Master of the Seaport when the Fishing Port Harbour Master could otherwise affect the jurisdiction of the Seaport Harbour Master.

The Harbour Master of each Seaport in Russia is appointed by the Federal Agency of Marine and River Transport and shall be directly subordinated to it. The Federal Agency of Marine and River Transport comes under the jurisdiction of the Ministry of Transport of the Russian Federation. At the same time the Harbour Master of each seaport is the Head of the Harbour Master's office, which forms part of the Port Authority (Seaport administration) of the Seaport.

According to the Regulations there are at least forty-four functions and authorities of a harbour master of the seaport in Russia, including:

- authority to permit ships to enter or leave the port;
- authority for ship movement control in the port approach;
- authority for ship movement control in the port area;
- planning of port operations;
- safety authority;
- competent dangerous goods authority;
- controlling ships emissions;
- calamity abatement;
- administrative duties etc.

The authority of a Harbour Master of the seaport in registering ships includes performing:

- (i) Registration of the vessel and titles to her in the State Ship Register or Bareboat Register or the Register of Vessels under Construction or Russian International Ship Register;
- (ii) Registration of deletion of the vessel from the State Ship Register or Bareboat Register or the Register of Vessels under Construction or Russian International Ship Register;
- (iii) Registration of change of port of registry of the vessel;
- (iv) Registration of changes of vessel's particulars;
- (v) Registration of mortgage over the vessel;
- (vi) Registration of Lease Agreement (Russian International Ship Register);
- (vii) Registration of change of the register.

Today, some 60 Harbour Master's officers administer 62 seaports, 10 estuary river ports and 16 fishing ports.

The Federal Agency of Marine and River Transport's ("*RosMorRechFlot*") is continuing to form Seaport administrations and is working on the integration of fishing and specialised ports under each Harbour Master's management. This reorganisation is being carried out according to the Russian Federation Degree No.773 dated 16 December 2006 on Improvement of sea fishing port's management systems and is aimed at integrated servicing of the fishing fleet. RosMorRechFlot is further looking at the creating Seaport basin administration to ensure safe navigation outside the Port area but within the territorial waters of the Russian Federation.

(d) Vessel's Crew Requirements under Russian flag

According to the Merchant Shipping Code the crew of a vessel shall consist of the master, other officers and the ship's crew. The officers of the vessel other than the master shall be mates, engineers, electricians, radio specialists and doctors.

Each vessel shall have aboard a crew whose members have the appropriate qualifications and whose members are adequate for:

- (i) ensuring safe navigation and protection of the marine environment;
- (ii) meeting the requirements on work time onboard the vessel;
- (iii) prevention of overcharging the crew members with work.

The minimum complement of the vessel's crew shall be determined by the transport authorities. A certificate as to the minimum crew complement shall be issued by the Harbour Master of the Seaport where the vessel is registered and throughout the period of registration of the vessel at that Seaport.

The crew of a vessel flying Russian flag may include citizens of the Russian Federation as well as foreign citizens and even stateless persons. At the same time the posts of Master, First Officer, Chief Engineer and Radio Specialist shall be filled only by citizens of the Russian Federation.

In order to be able to work onboard a Russian flag vessel a person shall have all necessary certificates confirming the state of health of this person and also licenses and qualification certificates issued by the relevant Harbour Master of the port based upon the results of examination of his knowledge and skills by a qualifications commission.

It has been suggested that it is economically disadvantageous to hire Russian seamen because of the Consolidated Social Tax issue. According to the Tax Code of the Russian Federation, if the annual salary of a seaman is under RUR 280,000

the shipping company will have to pay 26% of consolidated social tax for him, namely RUR 72,800. If his annual salary is RUR 600,000 the shipping company will have to pay RUR104,800 plus 2% of the amount in excess of RUR 600,000.

In its Letters (i) No03-03-06/1/320 dated 25 May 2007 and (ii) 03-04-06-021/23 dated 29 February 2008, the Department of Tax and Customs Policies of the Ministry of Finance of the Russian Federation clarified that crew salaries are exempt from Consolidated Social Tax if the vessel is registered in the Russian International Ship Register.

(e) Taxation of Shipping in Russia: shipowner's position

A shipping company is entitled to the exemptions from paying certain taxes and duties only if the relevant vessel is registered in the Russian International Ship Register. The key taxes for which exemption is granted are:

- (i) property tax – 2,2%;
- (ii) income tax – 24% on income received from the operation of such vessel provided that either the loading or the discharging port is located outside Russia;
- (iii) value added tax (VAT) on the construction of new builds on Russian yards or when a ship is imported into Russia to be registered in the Russian International Ship Register - 18%; and
- (iv) customs duties – 5%.

Pursuant to the Law No.168-FZ on Amendments to Particular Legislative Acts of the Russian Federation in connection with Formation of the Russian International Ship Register, the Government of the Russian Federation has approved Rules dated 16 July 2007 No. 448 on exemption from import customs duty in respect of a vessel imported into Russia to be registered on the Russian International Ship Register. The documents confirming the established registration of the relevant

vessel must be submitted to the Custom office within 45 days after the relevant tax declaration provided.

A VAT rate of 0% was established according to subparagraph 10 paragraph 1 of Article 164, paragraph 13 of Article 165 of the Tax Code of the Russian Federation and the Letter of the Ministry of Finance of the Russian Federation No 03-07/11/110 dated 25 March 2008 in respect of alienation of newbuildings vessels to be registered in the Russian International Ship Register. The Ministry of Finance determined the following documents shall be submitted to the tax authorities in order to be entitled to VAT rate of 0%:

- contract of realisation of a newbuilding (for example, shipbuilding contract or lease) entered into between the taxpayer (shipyard) and buyer/customer with an obligation to register the vessel in the Russian International Ship Register within 45 days from the transfer of ownership of the vessel from the taxpayer to the buyer/customer;
- extract from the Registry of Vessels under Construction stating that the vessel to be registered in Russian International Ship Register upon completion of construction;
- documents confirming the transfer of ownership of the vessel;
- documents confirming power of the main engines and tonnage of the vessel.

However, the above taxes and duty fall due for payment if the vessel is deleted from the Russian International Ship Register for reasons other than constructive and total loss (for example if the vessel is sold) within 10 years of the registration date.

(f) Cabotage issue

Cabotage, being general transportation and towage between ports located within the borders of the Russian Federation, cannot be carried out by vessels registered



in the Russian International Ship Register except when it is expressly provided by international treaties or the regulations by the Government of the RF.

Government Regulations No. 893 dated 17 December 2007 amended previous Government Regulations No. 404 dated 24 May 2000 on Rules on carriage or towage in cabotage by vessels flying foreign state flag in Russia. These Regulations establish that vessels registered in the Russian International Ship Register are entitled to carriage or towage in cabotage between ports of the RF only (i) if there is a requirement for a special vessel to carry on carriage or towage in cabotage which is not presented within the vessels registered in the State Ship Register; or (ii) there is an urgent need to perform carriage or towage in cabotage between the ports of the Russian Federation and there is no vessel registered in the State Ship Register available. Income from cabotage trade will be subject to established taxation procedures and will not benefit from the above exemptions.

#### 4.2 Comparison between the Norwegian International Ship Registry (NIS) and Russian International Ship Registry (RISR).

The Norwegian International Ship Registry was established in 1987 and designed for the foreign trading fleet. It is also open to tonnage which is not Norwegian owned<sup>7</sup>. Taking the latter as one of the obvious disadvantages of the Russian International Ship Registry, the below table shows other distinctions between international ship registries of the two countries.

As a main source for information on NIS, the website [www.nis-nor.no](http://www.nis-nor.no) has been used in course of preparation of this comparison.

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<sup>7</sup> Thor Falkanger, Hans Jacob Bull, Lasse Brauaset. *Scandinavian Maritime Law. The Norwegian Perspective*. Universitetsforlaget. 2004. p.54.

	NIS	RISR
Type of vessels	<ul style="list-style-type: none"> <li>- Cargo and passengers propelled vessels;</li> <li>- Hovercrafts;</li> <li>- Drilling rigs and other floating objects;</li> </ul> <p>The King of Norway has a right to extend the list of the vessels.</p>	<ul style="list-style-type: none"> <li>- Propelled or non-self-propelled floating constructions used for the purpose of merchant shipping.</li> </ul>
Legal Ownership	<p>(i) Norwegian national and/or company with 6/10 voting shares of the share capital (or EEA national/company).</p> <p>(ii) The main office of shipowner shall be in Norway or has its authorised representative there.</p>	<p>(i) Citizens and legal entities according to Russian law; the Russian Federation and the subjects of the Russian Federation.</p> <p>(ii) nuclear-power vessels can be owned by the Russian Federation only.</p>
Management of the vessel	Vessel shall be under technical and commercial management of a company incorporated and with its main office in Norway.	No particular provisions

<p>Carriage of goods, transportation of passengers and towage in cabotage</p>	<p>Carriage of goods, transportation of passengers between ports located within the borders of Norway and scheduled transportation of passengers between Norwegian and international ports cannot be carried out by vessels registered in the NIS.</p>	<p>Cabotage as a general transportation and towage between ports located within the borders of the Russian Federation cannot be carried out by vessels registered in the RISR with very limited exceptions.</p>
<p>Classification of vessels</p>	<p>NIS recognised the following Classification societies:</p> <ul style="list-style-type: none"> <li>- American Bureau of Shipping;</li> <li>- Den Norske Veritas;</li> <li>- Bureau Veritas;</li> <li>- Lloyd's Register of Shipping;</li> <li>- Germanischer Lloyds</li> </ul>	<p>Shipowner can appoint either Russian or foreign classification society for vessel registered in the RISR.</p> <p>However, the authority of a foreign Classification Society must be approved by relevant agreement entered into by the Government of the Russian Federation and the society.</p> <p>As of April 2008 Germanischer Lloyds is the first foreign classification society approved.</p>

Taxing	<p>(i) Personal income tax - 9.5-13.7%</p> <p>(ii) Social funds payments by employee – 7.8%</p> <p>(iii) Social funds payments by employer – 0-14.1%</p> <p>(iv) corporate income tax – N/A</p> <p>(v) estate tax – N/A</p> <p>(vi) transport tax – N/A</p> <p>(vii) VAT and custom duties in respect of imported vessels –N/A</p>	<p>(i) Personal income tax - 13%</p> <p>(ii) Social funds payments by employee – N/A</p> <p>(iii) Social funds payments by employer – 26%</p> <p>(iv) corporate income tax – N/A</p> <p>(v) estate tax – N/A</p> <p>(vi) transport tax – N/A</p> <p>(vii) VAT and custom duties in respect of imported vessels –N/A</p>
Guarantee on Insolvency	<p>In case of insolvency or liquidation procedures initiated against the shipowner the minimum amount of guarantee in respect of crew wages and repatriation costs is NOK 500,000 (USD 106,883) with an exception to small vessels with a number of crew members up to 5 -</p>	<p>There is no guarantees in case of insolvency or liquidation of shipowner for crew</p>

	NOK250,000 (USD 53,441).	
Crew nationality requirements	The master of the vessel should be a Norwegian or EU citizen. Other nations could be allowed to hold a master's office if they hired by the Norwegian Marine Directorate.	The master, first officer, chief engineer and radio specialist officers shall be filled only by citizens of the Russian Federation.
Registration fee (in relation to an Aframax tanker) and annual renewal	USD 22,829 (NOK 132,865) Annually USD18,837 (NOK 94,796)	USD 6,940 (RUR 163,000) Annually USD15,740 (RUR 370,000)
Ports of registry	70 ports in Norway	12 ports in the Russian Federation

#### 4.3 Mortgage registration

A mortgage over a Russian-flagged vessel can be granted and registered in favour of either a Russian or a foreign bank. The mortgage may be subject either to Russian law or foreign law. However, it should be noted that whatever the agreed law of the mortgage Russian law shall govern the enforcement procedure and remedies available to the bank upon default. Mandatory rules of Russian law relating to mortgages may also be applied may also be applied to the exclusion of the rules of foreign law.

Where a foreign-flagged vessel is registered in the Russian bareboat registry and is granted the right to fly Russian flag by virtue of such registration, a mortgage registered against the vessel in the registry of the underlying flag can be noted on the Russian bareboat registry. It then constitutes public notice of the existence of such mortgage. No mortgage can be registered on the Russian bareboat registry by way of primary registration.

(a) Governing law

The law governing registration of mortgages in Russia is consist of almost the same legislation as in relation to ship registration, namely:

The Civil Code of the Russian Federation ("the Civil Code");

The Merchant Shipping Code ("the MSC");

The Law on Mortgage, FZ No.102-FZ dated June 16, 1998 ("the Law on Mortgage");

The Rules of Registration of the Vessels and Rights to them in Commercial Seaports, dated 21.07.2006

The Rules of Registration of the Fishing Fleet Vessels and Rights to them in Fishing Seaports ports, dated 31.01.2001 as amended.

The Internal Waters Transport Code of the Russian Federation (there is only one article giving right to establish a mortgage over inland-waterways vessel).

Russia is also a party to the International Convention on Maritime Liens and Mortgages, concluded in Geneva on May 6, 1993 (the "Geneva Convention"). It joined the 1993 Convention on December 17, 1998 by issuing the Federal law "On the Russian federation Joining the International Convention on Maritime Liens and Mortgages of 1993" without any reservation.

Russia is not a party to the International Conventions for the Unification for Certain Rules relating to Maritime Liens and Mortgages concluded in Brussels on April 10, 1926 and May 27, 1967.

A mortgage may be effected over:

- (i) seagoing vessel;
- (ii) vessel of inland waters navigation, as well as those of mixed navigation (river-sea);
- (iii) vessel under construction.

A mortgage may not be registered in the Russian Federation:

- (i) over a foreign vessel to which the right to fly the State Flag of the Russian Federation is granted temporarily or
- (ii) over a vessel being constructed for a foreign recipient.

(b) Registration of mortgages

There is no special register of mortgages or other rights over a vessel in the Russian Federation. A mortgage over a vessel shall be registered in the same register where the vessel is registered. Therefore, a mortgage over a vessel shall be registered in one of the following registers:

- (i) State Ship Register;
- (ii) Russian International Ship Register;
- (iii) Bareboat Charter Register;
- (iv) Ship's book;
- (v) Register of Vessels under Construction.

A mortgage over a vessel under construction shall be registered in the Register of Vessels under Construction where the right of ownership of the vessel under

construction is registered. The Register of Vessels under Construction only contains information about vessels which are intended to be sea-going after completing the construction.

The Captain of a Commercial sea port executes the registration of mortgages over sea-going vessel or vessel currently under construction.

The Captain of a Fishing sea port executes registration of mortgages over fishing vessels.

The Maritime Administration of the relevant port conducts the receiving of documents, legal review and other work on preparation of the registration.

(c) Legislation requirements to the content of mortgage agreement

A mortgage over a vessel or a vessel under construction may arise only on the basis of contract.

The contract is to be entered into between the owner of the vessel or vessel under construction (mortgagor) and a bank (mortgagee) for the purposes of securing a pecuniary obligation. The mortgage may secure an obligation which arises, in particular, from a loan contract, including from a bank loan, from a sale contract, lease of property and other contracts.

A person holding the right of economic management of the vessel or vessel under construction may also be the mortgagor of it upon the consent of its owner.

Article 339 of the Civil Code and Article 10 of the Law on Mortgage specify that a mortgage contract must be concluded in written form and be subject to state



registration. The Law on Mortgage also specifies the minimum content of a mortgage agreement:

(i) description of the mortgaged vessel including

- name of the vessel;
- port or place of the registration;
- registration number;
- type and class;
- international tonnage certificate;
- call sign;
- time and place of building;
- basic dimensions;
- deadweight capacity

(ii) alternatively sufficient description of the mortgaged vessel under construction to allow identification of it (i.e. place where the construction is being made, yard number, type of the vessel, keel length and other basic dimensions, registration number);

(iii) estimated value of the vessel and

(iv) the nature, amount and deadline for repayment of the secured obligation;

The mortgage should be signed by the contracting parties and sealed.

According to the Federal Law of the Russian Federation "On Amendments to the Federal Law on Mortgage" dated November 30, 2004 No. 216-FZ as from January 2005 there is no obligation for a mortgage to be notarized in order to be valid. But the contracting parties may prefer their mortgage to be certified by a notary as an additional security measure and to avoid any delay in registration of mortgage.

Otherwise both of the parties might be asked to present for submitting the application for the registration of a mortgage.

Unless otherwise stipulated by the contract, the mortgage over a vessel shall attach to accessories of the vessel owned by the same owner and to the insurance compensation due under the contract of marine insurance of the vessel on the conditions of liability for total loss or damage to the vessel. The mortgage over a vessel does not extend to the freight.

Unless otherwise is stipulated by the contract the mortgage over a vessel under construction shall attach to materials and equipment intended for the construction for it, located at the shipbuilding organisation's place of business and distinctly identified by marking or by other means.

When two or more vessels or vessels under construction are the objects of a mortgage and in the absence of an agreement on the respective amount of security provided by each of vessel, each of them jointly and severally responsible to secure the obligation in full.

#### (d) Place of registration of mortgage

According to Article 376 of the MSC a mortgage over a vessel shall be registered at the port of registry of that vessel.

A mortgage over a vessel under construction shall be registered in the Register of the Vessels under Construction where the right of ownership of the vessel under construction is registered. The Register of the Vessels under Construction which, upon completion of construction are deemed to be seagoing vessels, shall be kept accordingly at the commercial seaports or fishing seaports located nearby shipbuilding organizations.

The Rules of Registration of Vessels contain the Index of forty-three (43) Commercial (Merchant) sea ports in Russia where a vessel may be registered in the State Ship Register and only twelve (12) of them are the sea ports where a vessel may be registered in the Russian International Ship Register, namely:

- Archangelsk
- Astrakhan
- Vladivostok
- Kaliningrad
- Korsakov
- Murmansk
- Nakhodka
- Novorossiysk
- Saint-Petersburg
- Taganrog
- Tuapse
- Kholmsk

(e) Form and number of the documents required

All the documents for the registration of mortgage shall be submitted in the Russian language. However, if any documents are in a language other than Russian, then such documents have to be accompanied by a Russian translated copy (apostilled and notarised).

According to the Clause 41 of the Rules all the documents must be presented in original and one copy of each for registration. After registration the originals to be returned and the Captain of the Commercial Sea Port retains the copy.

But when it comes to practice one should check with the Maritime Administration of the relevant Port in order to avoid any delays in the registration of mortgage. Usually, the Maritime Administration of the Port prefers to have its own original copy of the mortgage.

(f) Auxiliary documents to be produced to the registering authority when registering the mortgage

The contracting parties may be asked to submit some of the following documents to the registering authority:

- (i) the secured contract (loan contract, bank contract etc.);
- (ii) certificates of incorporation together with memorandum and articles of association of both parties (charters, memorandums of association, all amendments, certificates of registration and incorporation into the Uniform State Register of Legal Entities, tax registration certificates);
- (iii) extracts from the Uniform State Register of Legal Entities evidencing the absence of any amendments to constitutive documents as from the date of transaction;
- (iv) certified copy of the Minutes of a meeting of the Board of directors (or General meeting of shareholders) of mortgagor's company resolving the mortgage of the vessel;
- (v) certificates of incumbency;
- (vi) power of attorney;
- (vii) extract from shareholder register as from the date of transaction if applicable.

(j) The procedure for the registration of mortgage over a vessel or a vessel under construction

Article 377 of the MSC stipulates that a mortgage over a vessel or vessel under construction is registered upon an application of mortgagor.

In the application for the registration of mortgage the following information shall be given:

- (i) data identifying the vessel (name of the vessel, port or place of the registration, registration number, type and class, international tonnage certificate) or the vessel currently under construction (place where the construction is being made, yard number, type of the vessel, keel length and other basic dimensions, registration number);
- (ii) name and address of the mortgagor;
- (iii) name and address of the bank;
- (iv) maximum amount of the liability secured by the mortgage, and when the mortgage is effected in respect to two or more vessels or vessels under construction – the respective amount of liability secured by each vessel separately under the agreement thereof;
- (v) date of termination of the mortgage.

Prior to registration of the mortgage a legal review (due diligence) of the documents required for the registration shall be made by the Maritime Administration of the port. It should be noted that under relevant rules the Maritime Administration is entitled to take up to two months to have the mortgage registered. In practice it should happen more quickly especially if the owner of the vessel applies for the registration.

A registration may be denied if the mortgage or the documents enclosed do not meet the requirements for registration of the mortgage over a vessel or vessel under construction. For example, if a mortgage secures a pecuniary obligation the

amount of which is not identified at the moment of concluding the contract of mortgage.

The mortgage over a vessel or vessel under construction shall be registered on the day of receipt of the application for registration. The mortgage contract shall be deemed to be concluded as of the moment of the registration. Non-compliance with the requirements for registration of mortgage makes the mortgage null and void.

The Captain of the relevant port registering the mortgage over a vessel or vessel under construction shall issue to the mortgagor and bank a certificate of registration of the mortgage over a vessel in a standard form.

Where two or more mortgages are registered over the same vessel or vessel under construction, the ranking of claims arising out of duties secured by the mortgage between them shall be determined as to the dates of their registration. The mortgage registered earlier shall have priority over the mortgage registered later. Mortgages registered on the same day shall have equal force. The ranking of claims arising out of duties secured by a mortgage may be changed by agreement between the mortgagor and banks. Such agreement is subject to registration with the relevant Register.

(h) Assignment of the mortgage over a vessel or vessel under construction to another party

A bank shall be at liberty to assign the mortgage over a vessel or vessel under construction to another party, only together with the pecuniary duty secured thereby. The assignment of one without another shall not be permitted.

In the event of an assignment of the mortgage an entry on the date of the assignment and the name of the person in favour of whom the assignment was effected shall be made in the relevant Register or Ship book.

(i) Enforcement procedure

When a mortgagor has failed to perform his duty to pay on secured obligation, the bank has the right by law to pursue satisfaction of his claim by the forced sale of the vessel or vessel under construction under a court decision by means of public sale or at auction.

Article 55 of the Law on Mortgage stipulates that the parties can agree on other methods of satisfaction of the demand of the bank without legal recourse. After the claim under the mortgage has accrued (i.e. default) the parties can conclude a notary certified agreement on the mortgaged property to be sold out on the auction organised by the bank or bank can acquire mortgaged property and set off purchase price against secured obligation. The right to take possession of and sell the vessel or vessel under construction by private sale is not recognised by the Russian law.

But the most efficient way should be a forced sale of the vessel or vessel under construction being arrested first.

Prior to the forced sale of a vessel or vessel under construction the court shall be obliged to provide a notice thereof to:

- (i) the authority in charge of registration of the vessel or vessel under construction;
- (ii) all banks of the registered mortgages of the vessel or vessel under construction and all holders of maritime lien on the vessel in respect of the claims set out in

Article 367 of the MSC provided that the holders have notified the court of their respective claims;

(iii) the registered owner of the vessel or vessel under construction;

(iv) the authority in charge of registration of the vessel in the state whose flag the vessel is temporarily permitted to fly.

According to the Article 367 par 1 of the MSC the abovementioned claims shall relate or arise out of:

(i) wages and other sums due to the master and other members of the vessel's complement in respect of their employment on the vessel, including costs of repatriation and social insurance contributions;

(ii) compensation for loss of life or personal injury of a citizen occurring, whether on land or on water in direct connection with the operation of the vessel;

(iii) salvage of the vessel;

(iv) port, canal, pilotage and other fees;

(v) compensation for physical damage caused by the operation of the vessel as a result of loss or damage to property other than cargo, containers and passengers' property and caused otherwise than a result of oil, noxious substance or radioactive pollution.

The notice of the forced sale of the vessel or vessel under construction shall be provided to authorities and persons enumerated by registered mail or given by any electronic or other appropriate means of communication which provide confirmation of receipt. In addition, the notice may be published in official periodical press in the place where the forced sale is conducted. The sale is carried out by bailiffs or by court-appointed auctioneers. The starting price is determined by the court on the basis of market price of the vessel which prima facie is the value agreed in the mortgage. The sale is subject to Russian VAT.



In the event of the forced sale of the vessel or vessel under construction all registered mortgages over a vessel or vessel under construction, except those assumed by purchaser with the consent of banks, all liens and other encumbrances of whatsoever nature shall cease to attach the vessel or vessel under construction.

In regard to the treatment of priority of various claims against the vessel or vessel under construction upon enforcement the bank ranks ahead of all claims except:

- (i) claims by port authorities for salvage where the vessel as a sunk wreck (and importantly in this regard, Russian law treats a ship mortgage as attaching to insurance proceeds in case of total loss of the vessel which means that the port authorities may have priority right to claim payment out of insurance proceeds);
- (ii) claims secured by a shipbuilder's lien or ship repairer's lien and
- (iii) claims secured by maritime lien and stipulated in Article 367 par 1 of the MSC.

These are claims relating to or arising out of:

- (i) master's and crew wages and social security contributions/repatriation expenses;
- (ii) damage to health or life caused by operation of the vessel otherwise than as a result of oil, noxious substance or radioactive pollution;
- (iii) salvage of the vessel;
- (iv) port, canal, pilotage and other fees; and
- (v) damage to property other than cargo, containers and passengers' property and caused otherwise than as a result of oil, noxious substance or radioactive pollution.

These claims cease to be secured by maritime lien and lose priority of the vessel is not arrested within one year of the accrual of the claim.

(j) Termination of the mortgage over a vessel or vessel under construction

A mortgage over a vessel or vessel under construction shall be terminated in the event of:

(i) discharge of a debt;

(ii) debt redemption by way other than discharge (forced sale and others);

(iii) wreck of the vessel or vessel under construction with the exception when the bank may implement his claim for the insurance indemnity.

Upon production of evidence for the termination of the mortgage over a vessel or vessel under construction the authority in charge of registration shall make an entry on the termination of the mortgage in the relevant register.

## 5 Conclusion

The scope and direction of work undertaken in order to consider the issues set out in the introduction of this thesis can be summarised in the following conclusions:

(i) Shipping finance is a typical example of an asset-based finance with certain distinctive characteristics such as:

- (a) capital intensity;
- (b) mobility of assets;
- (c) volatility; and
- (d) business structure.

(ii) A typical shipping transaction will include a ship or ships (owned by a special purpose vehicle) over which the banks will hold a mortgage, an assignment of insurances and earnings, pledge of shares and a guarantee from a parent company or beneficial owner.

(iii) The financing structure that a particular borrower may be offered will be determined by:

- (a) the credit standing of the borrower;
- (b) the level of security offered; and
- (c) the cash flow cover.

(iv) No matter how innovative the security package in a ship finance structure aims to be, the ship mortgage will remain one of its cornerstones. Duly registered, the mortgage will provide the bank with a legal, valid and enforceable interest in the vessel. The bank will have priority to satisfy their claim against the shipowner ahead of other unsecured creditors. Although, the claims giving rise to a maritime lien will rank ahead of a mortgage.

(v) Ship mortgages are almost invariably governed by the law of the flag of the ship. The borrower should always bear in mind what the bank will be looking for considering the law of the flag and type of registry of the vessel. The bank will wish to see:

(a) a well-established flag;

(b) a flag with a good reputation for safety and supervision, which has an effective system for monitoring and enforcing those standards, so that the bank can be assured that the value of the ship is being preserved;

(c) there is an effective mortgage registration system, which is widely recognised outside the country in question and where enforcement procedures have been seen to work in the past;

(d) well established maritime laws upon which clear and consistent legal advice can be given;

(f) a flag which gives a bank the right to assume management of the ship and to take possession and sell the ship by private sale, if there is an event of default under the underlying loan agreement;

(g) a flag which gives as few as possible priority to the maritime liens;

(h) the ship and her owner can satisfy all applicable eligibility and registration requirements.

(vi) The ship registration system under Russian law is established by the relevant federal legislation but it is not a quite straightforward process. It requires an owning company to be incorporated in Russia which cannot be run through nominee directors and/or shareholders (as for example in Cyprus). There are no provisions for a management company.

(vii) Absence of any provisional registration of the vessel does not allow coordinating the process with the registration authority and the bank. This may be a reason for a bank to require additional security for the period required to obtain the relevant registration. In the end it could make the structure of the transaction over-secured and complicated as well as time-consuming.

(viii) The Russian legislation does not prescribe the form of mortgage. Therefore, a legal opinion should be obtained before proceeding with registration of the mortgage over the vessel confirming that the mortgage agreement satisfies minimum content set out in the Civil Code of the Russian Federation.

(ix) The comparatively short period of the action of the Russian International Ship Registry, as well as sufficiently rare application in practice of credit organizations Russian mortgages as a security over the vessels, do not make it possible to speak about commonly formed practice.

(ix) There are, however certain improvements which could be already undertaken in relation to ship and mortgage registration in Russia, for example:

(a) establishment of a centralised system with access to it in each of the ports;

(b) a prescribed (statutory) form for mortgages to be registered over the vessels in the Russian International Ship Registry;

(c) to reduce the time for registration of vessel and mortgage over the vessels in each Registry;

(d) to establish preliminary registration of the vessels;

(e) further amendment of the relevant articles of the Tax Code to clarify exemption from VAT and custom duties in relation to the vessels to be registered in the Russian International Ship Registry and their equipment and/or machinery imported into Russia.

The more clear and regulated system of ship and mortgage registration would be further set out in Russia, the more banks and borrowers might be interested in incorporating a Russian mortgage as a security in their ship finance structures.

Otherwise, Russian shipping companies will continue register their newbuildings delivered in accordance with ship finance transaction under foreign flag. During 2003-2007, 98% of all newbuildings ordered by Russian shipping companies have been delivered under foreign flag.

This thesis may be limited to a certain level of theoretical rather than practical observation of the problems discussed, and might not have enough comparison in relation to procedures of ship and mortgage registration in other jurisdictions. At the same time, the thesis provided the possibility for the author to structure her own knowledge and develop skills in registration of ship and mortgage over vessels in different jurisdictions.

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