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ASPECTS OF SHIP
FINANCING IN AUSTRALIA

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ASPECTS OF SHIP FINANCING IN AUSTRALIA

This paper deals with certain aspects of financing ships in Australia.

The paper is set out as follows:-

- Section 1 - Background
- Section 2 - The Shipping Registration Act, 1981
- Section 3 - Leveraged lease financing
- Section 4 - Observations for the future

SECTION 1 - BACKGROUND

1.01 The subject to be discussed today should be looked at in the context of the current trend towards fixing mineral export contracts on CIF terms in preference to FOB terms, and the increasing pressure from the Australian maritime unions for greater "Australian" flag participation in the Australian export trade.

1.02 Until very recently, a large proportion of Australian export contracts for minerals were fixed on FOB terms, pursuant to which the overseas buyer was obliged to provide a ship to load the cargo concerned at a designated port in Australia. FOB contracts were used because of convenience to the buyer and because the seller was saved the time and trouble of providing a ship. In addition there was always the inherent risk that the seller would be obliged to provide an "Australian" flag ship with all the cost disadvantages which this entailed.

1.03 However, the advantages of selling on CIF terms have become increasingly apparent over the last few years. The major merit, within the shipping sphere, of selling on CIF terms is one of control. Although his contract may call for a certain size of cargo to be loaded within a given period, the supplier commonly has the ability to decide the exact date of shipment and organize his production and storage arrangements accordingly. In general terms therefore, a seller on CIF terms is not at the mercy of an element beyond his control. The fact that a seller is able to control shipments puts him in a strong position, in the event of a dispute with a buyer. In addition, a CIF seller also stands to gain if the freight market moves in his favour during the currency of the sales contract.

1.04 An example of the trend towards CIF selling is to be found in the recent announcement that a letter of intent has been signed between the North West Shelf participants and a group of Japanese utility companies for the supply of liquified natural gas over a long-term period.

1.05 In supplying ships to fulfill their obligations under sales contracts on FOB terms, buyers have shown a distinct preference for foreign tonnage, particularly from the "flag of convenience" registries. These flags, typically Liberian, Cypriot, Panamanian and Bahamian enable their owners to utilize crews other than the country of origin of the owner. The advantage of using "flag of convenience" tonnage was that considerable savings could be achieved in relation to crewing costs. The savings involved are not as great as they once were, due to the growing influence of the International Transport Workers Federation (ITF) which endeavours to ensure that a minimum scale of wages is paid to all crews of whatever nationality. In addition, the cost of bunkers has assumed a far greater percentage of overall

expenditure than crewing costs. For example, in 1978 it was estimated that, for a standard type of bulk carrier of about 60,000 metric tons deadweight on the Tokyo-Sydney-Takyo run, the cost of bunkers represented an average of only 25% of the freight rate. Today, the position of bunkers as a percentage of the same freight rate would be around 50% and it continues to rise. To take another example, the daily cost of fuel for the bulk carrier referred to in the previous example is approximately double the other daily running costs for that vessel.

1.06 The significance of this so far as Australia is concerned is that the relative difference in running costs between similar vessels operated under the Australian and foreign flags is no longer as great as it once was and it is expected that the relative difference will decrease even further as the cost of bunkers continues to escalate. However, it is acknowledged that the crewing costs of an "Australian" flag vessel can be significantly more expensive than for a vessel which, for example, is registered in Hong Kong or Singapore. On the other hand, a shipowner has to take into consideration the very real risk of strikes and boycotts, in the event that the owning company's link with a country other than the country of registry is discovered.

1.07 At the time of writing, there is an informal ban on FOC vessels operating on the New South Wales coast. The avowed aim of this ban is to ensure greater opportunities for participation by "Australian" flag vessels in our export trade, and this will inevitably lead to better employment opportunities for the members of the Australian maritime unions involved. Schedule 1 to this paper contains a copy of an article which was published in "The Australian" on 10th September, 1981 and it provides some interesting insights into the current industrial unrest.

1.08 It is against this background of industrial unrest and the desire by Australian exporters to retain greater control of their products by selling on CIF terms that the Shipping Registration Act, 1981 (C'wealth) has been enacted. As we shall see, the Shipping Registration Act opens up the possibility of a substantial increase in "Australian" flag tonnage and with it, the prospect that operators will look increasingly to Australian financial institutions and methods to finance a substantial proportion of the cost of acquiring new ships.

1.09 The Shipping Registration Act is relevant to the present topic, as it will provide the legislative framework within which Australian ships are to be registered and to operate. An owner will be concerned to ensure that, so far as possible, he has a clear and unimpeachable title to his ship. This will be of advantage to him if he wishes to finance all or part of the cost of acquiring a ship, as he will be able to furnish evidence of his title to

a prospective lender. Equally, a lender will be concerned to ensure that the security which he receives in the form (inter alia) of a mortgage over the ship, is enforceable. He will need to have a broad general knowledge of the way in which the Shipping Registration Act works. In particular, a lender will be looking for confirmation that the owner or operator is in fact who he says he is, that the ship is entitled to be registered on the Australian Register of Ships and that there is a clearly defined system of priorities in relation to registered mortgages.

SECTION 2 - SHIPPING REGISTRATION ACT, 1981

2.01 Background to registration of vessels in Australia

2.01 It is convenient to describe ships registered in Australia as "Australian" flag ships. However, this is really a misnomer, as the principal legislation applying in Australia at present to the registration of ships and ship mortgages and other matters relating to the registration of ships is the United Kingdom Merchant Shipping Act, 1894. Under the MSA, ships are registered in Australia as "British Ships" by officers of the Department of Business and Consumer Affairs acting as "Registrars of British Ships".

2.02 The Shipping Registration Act ("the Act") was assented to on 25th March, 1981 and present indications are that it will probably come into force on or about 7th December, 1981. Under the Act responsibility for the registration of ships in Australia will be vested in the Commonwealth Department of Transport.

Purpose of the Act

2.03 The main and fundamental reason for the new Act is to enable Australia to grant its nationality to Australian ships, to exercise its jurisdiction and control in administrative, technical and social matters over such ships and to enable them to fly the Australian National Flag or the Australian Red Ensign, in accordance with Australia's obligations under the Geneva Convention on the High Seas 1958, to which Australia is a party. The Act repeals Part 1 of the Merchant Shipping Act, insofar as that Act applies to Australia. However, there are transitional provisions which are designed to ensure as smooth a changeover as possible, and these will be discussed in greater detail later. However, the effect of Section 86 (when read with Section 85) of the Act is that every ship registered in Australia under the Merchant Shipping Act is automatically deemed to be registered under the Act as an Australian ship, and any entry or record on the register book of "British" ships kept at a port in Australia is automatically deemed to be a record or entry made in the Australian Register of Ships. In addition, Section 88(1) provides that any documents (excluding a certificate of mortgage or a certificate of sale) made in accordance with the MSA and in force immediately before the commencement of the Act and any endorsement, memorandum or other note made under the MSA on any such document and in force immediately before the commencement of the Act is to continue to have the same effect as if made under the Act. These sections should be of considerable comfort to owners and mortgagees, as their respective interests will not be challenged by the Registrar of Ships for at least six months after the Act comes into force.

Registration of Australian Ships

2.04 The Act establishes an Australian Register of Ships in which there is to be entered all matters required or permitted by the Act to be entered in the Register. (Section 56(1)). At present, it is envisaged that the Register will contain the following:-

- (a) The name of the ship;
- (b) General particulars of the ship;
- (c) Propulsion details;
- (d) Tonnage or measurement details;
- (e) Details of the current owner and the registration number;
- (f) Details of current mortgages.

Location of the Register

2.05 The present arrangement under the Merchant Shipping Act whereby a separate register of "British Ships" is kept at each "British Port" of registry in Australia is to be abolished. Instead there will be an Australian Shipping Registration Office (Section 54(1)(a)) established in Canberra at which the Australian Register of Ships (Section 56(1)) will be kept. Branch offices will be established in all Australian ports which are presently "British" ports for the purposes of the Merchant Shipping Act, together with such other ports as may be gazetted for that purpose (Section 54(1)(b)). A list of current "British Ports" in Australia is to be found in Schedule 2. They will be known as home ports under the Act, for the purpose of marking. Copies of the Register will be retained in each State capital and Darwin, although it is envisaged that they will only contain details of ships whose home port is in the State or Territory concerned.

Definition of "Ship" for the purposes of registration

2.06 A "ship" is defined to mean any kind of vessel capable of navigating the high seas and includes -

- (a) a barge, lighter or other floating vessel;
- (b) a structure that is able to float or be floated and is able to move or be moved as an entity from one place to another (eg. non-self propelled offshore industry vessels such as oil rigs); and
- (c) an air-cushion vehicle or other similar craft, used wholly or primarily in navigation by water (eg. a hovercraft).

but does not include a vessel, structure, vehicle or craft declared by the regulations not to be a ship for the purposes of the definition.

2.07 This brings the present position in Australia into line with the position in the United Kingdom where, as a result of a directive issued by the U.K. Department of Trade in or about 1975, the definition of "ship" for the purposes of Part 1 of the Merchant Shipping Act now includes "units capable of movement at sea whether self-propelled or not". Dumb-barges, pipe laying barges, crane barges, and vessels used as floating oil tanks fall within this extended definition, and the U.K. Department of Trade has advised that it also regards submersibles and jack-up rigs (other than those required to be put on barges to move from one location to another) as ships required to be registered under the Merchant Shipping Act if their owner(s) are qualified to own a British ship.

Ships required to be registered

2.08 Under the Act, every commercial "Australian-owned ship" of 12 metres or more in length and capable of navigating the high seas is required to be registered (Section 12(1)) unless specifically exempted under Sections 12(2) or 13. If it is not so registered the owner of the ship is guilty of an offence and the ship may be detained until registration is effected, whether or not proceedings are instituted for such an offence (Section 12(3)). It is not a defence to a prosecution for such an offence that the ship required to be registered is registered under a foreign flag (Section 12(4)) and provision is made in Section 87(1) for transfer from a foreign registry in certain circumstances.

Ships exempted from compulsory registration

2.09 Ships exempted from compulsory registration are Government ships, fishing vessels, pleasure craft, small craft (Section 13) and (with the consent of the Minister) a commercial "Australian-owned ship" of 12 metres or more in length and capable of navigating the high seas which is operated by a foreign resident under a demise charter (Section 12(2)). The effect of Section 12(2) is to give reciprocity to a foreign charterer in circumstances where the provisions of Section 14(d) would permit a ship on demise charter to an Australia-based operator to be registered under the Act. A "Government Ship" is defined in Section 3 of the Act as being a ship of 12 metres or more in length that belongs to a Government Authority (ie. the Commonwealth or a State or Territory, or a body corporate established for a public purpose by or under a law of the Commonwealth or of a State or Territory other than the Australian Shipping Commission, The Western Australian Coastal Shipping Commission or a body corporate exempted by the regulations) and to no other person, or the beneficial

interest in which is vested in a Government Authority and in no other person, or that is for the time being on demise charter to a Government Authority and to no other person.

Ships permitted to be registered

2.10 Section 14 of the Act specifies ships which may be registered and these are as follows:-

- (a) Australian-owned ships which are exempted from compulsory registration under Section 13 (ie. Government Ships, fishing vessels, pleasure craft and small craft);
- (b) Small craft (ie. ships less than 12 metres in length) wholly owned by Australian residents (ie. a body corporate, wherever incorporated, that has its principal place of business in Australia, a person whose permanent place of abode is in Australia (regardless of whether or not he is temporarily absent from Australia) or a person domiciled in Australia, unless his permanent place of abode is outside Australia) or by Australian residents and Australian nationals;
- (c) Small craft operated solely by Australian residents or Australian nationals or both;
- (d) Ships on demise charter to Australian-based operators. ie. a ship (not required to be registered under Section 12 or permitted to be registered under the preceding sub-clauses) on demise charter to:-
 - (i) an Australian national(s) and to no other person; or
 - (ii) two or more persons who include an Australian national(s) where such Australian national(s) is in a position to control the exercise of the rights and powers of the charterers under the charterparty (Section 9).

In general terms, a ship on demise charter to an Australian-based operator can be registered in Australia if the owners agree and the foreign registration authority is prepared to close its register for the ship (see Section 17(1)).

Small craft and pleasure craft

2.11 A significant development of the Act is that it permits "small craft" and "pleasure craft" (ie. a ship used, or intended to be used, wholly for recreational or sporting activities, whether or not let, or intended to be let, for hire or reward or consideration of any kind) to be registered. This is of benefit to an owner as his title to the craft concerned will become a matter of public record

upon registration. It will also provide some comfort to a lender who has advanced money on security of such a craft, as he will be able to register a mortgage.

Ships on demise charter to Australian-based operators

2.12 The registration of ships on demise charter to Australian-based operators is also a significant development. Apart from defining the eligibility for Australian registration of ships on demise charter, Section 9 is supposed to ensure that Australian nationals have more than a 50 per cent interest in the charter. However, it is possible to envisage circumstances in which an Australian national(s) may have less than a 50 per cent interest in a charter, notwithstanding that it may be in a position to control the exercise of the rights and powers of the charterers.

Qualifications for ownership of an Australian ship

2.13 Under the Merchant Shipping Act, a "British" Ship can only be owned by an individual who is a British subject or a body corporate established under and subject to the laws of some part of Her Majesty's Dominions (which includes Australia) and having its principal place of business somewhere in those Dominions. Section 5(1) of the MSA provides for British ships to be divided into 64 shares and any share may be owned by up to 5 persons jointly (excluding beneficial interests).

2.14 Under Section 8(1) of the Shipping Registration Act, an Australian ship can be owned:-

- (a) by an Australian national(s) (ie. an Australian citizen or a body corporate established by or under a law of the Commonwealth or of a State or Territory, or the Commonwealth or a State or Territory) and by no other person;
- (b) by not less than 3 and not more than 5 persons (see Section 11(1)(c)) as joint owners where the majority are Australian nationals. Joint owners are those in whom the property in a ship is vested jointly, with unity of title and no distinction of interest; or
- (c) by 2 or more persons as owners in common, where more than 32 of the 64 shares in the ship are owned by an Australian national(s). Owners in common are those in whom distinct shares in the ship are vested in severalty but with an undivided interest in the whole.

2.15 Section 8(2) of the Act outlines the approach for calculating Australian ownership where the ship is owned by two or more persons as owners in common AND where two or more persons are joint owners of a share or shares in that ship. In the case of 2 or more shares that are owned by the

same persons, the interest of each joint owner is to be ascertained by dividing the number of jointly owned shares by the number of joint owners. Where such shares are owned by different persons, the interest of each joint owner of a particular share is to be ascertained by dividing the number of shares by the number of owners of the share. The interests of Australian nationals so ascertained are added together for the purpose of determining Australian ownership, and fractions are deducted from the total.

2.16 Section 8(1) of the Act contains one significant departure from the Merchant Shipping Act, in that a body corporate is not required to have its principal place of business in the U.K., Australia or any other part of H.M. Dominions. All that is required is that it should be "established by or under a law of the Commonwealth or a State or Territory", and the nationality of the shareholders is irrelevant. A body corporate is merely required to produce its certificate of incorporation when applying to the Registrar to register a ship on the Australian Register. Under the MSA, the nationality of the shareholders of a body corporate is also immaterial for the purpose of determining whether such body corporate is qualified to own a share in a British ship. As indicated above, the real criterion for determining any such qualification is where the corporation has its principal place of business and this is a question of fact which is generally determined by reference to the locality of control of the business of the corporation i.e. where the principal decisions regarding the corporation are made and if as is usual, such decisions are made by the company's board of directors, the locality of board meetings and residence of the majority of the directors is strong evidence as to locality of control. However, this criterion is also relevant for the purpose of determining whether a body corporate has its principal place of business in Australia in order to qualify as an Australian resident under Section 3(3)(c) of the Act.

Documentation Required for Registration

2.18 The documentation required for registration of a ship on the Australian Register of Ships is prescribed by regulations which are still to be made. However, it appears that the following documents will be required to enable a newbuilding or a second-hand ship to be registered under the Act:-

- (a) a Builder's Certificate (except where the ship has previously been registered in Australia). Where the original Builder's Certificate has been lost or mislaid, a new certificate can be prepared by a person qualified to do so (eg. a marine surveyor or a naval architect).
- (b) a Bill of Sale (Section 36(1)). Where application is made for registration of a second-hand vessel the Registrar will also require production of all

previous bills of sale relating to the disposition of the ship. Where any such bill of sale has been lost or mislaid the applicant for registration will be able to place an advertisement in each of a local newspaper and a national newspaper and anyone objecting to registration of the ship is required to lodge notice of objection within 30 days. It appears that there will be no prescribed form for a bill of sale and it will therefore be left to the parties to determine the form which this should take.

- (c) a Declaration of Transfer to be made by the buyer in accordance with the regulations (Section 36(2)). Under Section 36(3), where the buyer is not the Commonwealth or a State or Territory, the Declaration of Transfer must include the following details:-
- (i) in the case of a transfer of a ship or a share in a ship, other than a small craft,
 - (aa) a statement specifying the nationality of the buyer or where the buyer is a body corporate the country in which it was incorporated; and
 - (bb) a statement that to the best of the knowledge and belief of the person making the declaration, the ship concerned will not cease to be an Australian-owned ship by reason only of the transfer.
 - (ii) in the case of a transfer of a ship, or a share in a ship, being a small craft, the statements specified in (a) above, and
 - (aa) a statement specifying the normal place of residence of the buyer or, where the buyer is a body corporate, the principal place of business of the body corporate; and
 - (bb) a statement that, to the best of the knowledge and belief of the person making the declaration, ship concerned will not cease to be a "small craft" within the description in Section 14(b) and (c); and
 - (c) a Certificate of Deletion in respect of a ship which has previously been registered on a foreign register (see Section 17); and
 - (d) a Tonnage Certificate issued under or having effect by virtue of the Navigation Act, 1912 (C'wealth), in the case of a ship required

to be registered under Section 12 of the Act or a ship permitted to be registered under Section 14 of the Act which is not less than 24 metres in length. Therefore, Government ships, fishing vessels, small craft and pleasure craft (such as yachts) which are less than 24 metres in length will not need to be measured for tonnage; or

- (e) a Measurement Certificate in respect of ships permitted to be registered under Section 14 of the Act which are less than 24 metres in length, and therefore are not required to produce a Tonnage Certificate; and
- (f) a Marking Note indicating that the ship has been properly marked in accordance with the Regulations (ie. with her name, home port, tonnage or measurement (as the case may be) and official number;

2.19 Where the ship is demise chartered to an Australian based operator, the Registrar will require production of the original charterparty (in addition to the other documents referred to above) prior to registering the ship under the Act. Upon registration, it will also be possible to register a foreign mortgage on the Australian Register.

Transfer of a ship already registered in Australia

2.20 Part III of the Act deals (inter alia) with the transfer of a ship which is already registered, and the relevant provisions should be read subject to the provisions of Section 48 of the Australian Shipping Commission Act, which requires the Minister's prior consent to a transfer of a ship (or a share in a ship) which is:-

- (a) registered in Australia; or
- (b) owned, managed or controlled by an Australian resident or by a body corporate whose principal place of business is in Australia,

to a person not resident in Australia or to a body corporate whose principal place of business is not in Australia (Section 48(1)(a)).

In addition, Ministerial consent is required prior to an application for the transfer of the registration of any ship registered in Australia to a registry outside Australia (Section 48(1)(c)). Any transfer effected in breach of Section 48(1) is void (Section 48(2)). The avowed purpose of Section 48(1) is to ensure that adequate shipping is available for the purposes of trade and commerce among the States and for the purposes of the trade and commerce of Commonwealth Territories (Section 48(5)).

Provisional Registration

2.21 A provisional registration certificate shall be issued by certain Australian diplomatic or consular representatives in foreign ports where the original registration certificate has been mislaid, lost or destroyed (Section 21(2)) and may be issued by such diplomatic or consular representatives where the ship becomes entitled to have Australian registration while abroad (Section 22(1)). The object in both cases is to enable an Australian ship to sail without being properly registered under the Act. In either case, a provisional registration certificate has the same effect as a registration certificate for a period of six months after its issue or until the ship arrives at an Australian port whichever is first. The Registrar of Ships is empowered to extend this time limit upon application (see Sections 21(5) and 22(4)) and may grant a further provisional registration certificate upon surrender of the old one (see Sections 21(7) and 22(6)).

Temporary pass

2.22 Temporary passes are also available to permit an unregistered Australian ship to travel from an Australian port to a foreign port or from a foreign port to another foreign port or to an Australian port, subject to the terms and conditions thereof. A temporary pass has the same effect as a registration certificate (Section 23) and for the purposes of the Act and of the lawful navigation of the ship on the voyage specified in the pass, the ship is deemed to be registered. Finally, it should be noted that a temporary pass is only available for a one way voyage.

Legal effect of registration

2.23 Section 19 of the Act provides that the Registrar shall grant a Registration Certificate in respect of a ship registered under Section 18. A Registration Certificate is not a document of title, as Section 20(1) of the Act restricts its use to the lawful navigation of an Australian ship. This continues the present position under Section 15(1) of the Merchant Shipping Act. While registration constitutes evidence of title, it is not conclusive. Evidence of title is dealt with in Section 77(2) of the Act which makes provision for the Registrar to supply certified copies of, or extracts from, any entry in the Register. Such a copy or extract is admissible in evidence (Section 77(4)) in any proceedings as prima facie evidence of any matter stated therein (Section 77(1)).

2.24 However, the registered owner of an Australian ship or a share therein has power (subject to the Act and to any rights and powers appearing in the Register to be vested in any other person) absolutely to dispose of the ship or such share and to give effectual receipts therefor (Section 45). Therefore, it is submitted that a buyer who receives a bill of sale executed by or on behalf of the registered owner of

a ship will obtain good title if he is a bona fide purchaser for value and does not have notice that the registered owner is not the true owner of the ship and provided that there is no mortgage registered against the ship.

Position of an unregistered Australian ship

2.25 A ship required to be registered under the Act but which is not registered:-

- (a) will not be recognised as an Australian ship; and
- (b) will not be entitled to any benefits, privileges, advantages or protection usually enjoyed by a registered ship (see Section 63) unless it has been issued with a provisional registration certificate or a temporary pass; and
- (c) may be detained until registration is effected (Section 12(3) and the owner is liable to a fine (Section 74(4)(a)).

2.26. In addition, where an unregistered ship entitled to be registered (i.e. required to be registered by Section 12 or permitted to be registered by Section 14):-

- (a) is at an Australian port, it may not leave Australia (Section 68(1) and a Collector of Customs is prohibited from granting a Certificate of Clearance under the Customs Act, 1901 (Section 68(3));
- (b) is at a foreign port at which there is an Australian diplomatic or consular representative, it may not leave the port unless a registration certificate or a provisional registration certificate is granted in respect of the ship (Section 69(1)) unless it is a prescribed ship or a ship included in a prescribed class of ships.

2.27 The general provisions of the Act dealing with unregistered ships entitled to be registered are far wider in their scope than the provisions of the Merchant Shipping Act. Under the MSA, the only sanction available against an unregistered ship is to detain it until registration is effected, although the owner of an unregistered ship entitled to be registered under the MSA is required, prior to obtaining an Australian customs clearance, to make a statutory declaration pursuant to which a waiver is given of all rights to Australian Government protection.

Registration of mortgages on Australian ships

2.28 The provisions of the Act dealing with mortgages are to be found in Part III. They are to be read subject to the provisions of Section 48 of the Australian Shipping

Commission Act which requires the Minister's prior consent to a mortgage or transfer of mortgage in respect of a ship (or a share in a ship) which is:-

- (a) registered in Australia; or
- (b) owned managed or controlled by an Australian resident or by a body corporate whose principal place of business is in Australia,

to a person who is not resident in Australia or to a body corporate whose principal place of business is not in Australia. (Section 48(1)(b).) A mortgage or transfer of mortgage in breach of that section is void (Section 48(2)).

2.29 A registered ship or a share therein may be made a security for the discharge of an obligation by way of a mortgage under the Act (Section 38(1)). This means that it is possible to register a mortgage over all ships required or permitted to be registered under the Act, provided that they are registered. There will be no prescribed mortgage forms and it is therefore open to the parties concerned to produce their own forms. All that will be required is a summary specifying (inter alia) the name of the ship, the official number, the name of the mortgagee(s) and the nature of the consideration. A statutory declaration will also be required to the effect that the mortgage contains the details supplied in the summary.

2.30 The Registrar is required to register a mortgage as soon as practicable after lodgment, by entering particulars of the mortgage on the Register (Section 38(3)). A mortgage is deemed to be lodged only when the requirements of the Act in relation thereto have been satisfied. Mortgages are to be registered in order of their lodgment (Section 38(4)).

2.31 A mortgage does not have the effect of the mortgagee becoming, or the mortgagor ceasing to be, the owner of the ship or share except to the extent necessary to make the ship or share available as a security under the mortgage (Section 40).

2.32 It appears that a valid and binding ship mortgage will, of itself, create a valid and binding charge on the ship concerned and will possess the normal attributes of a chattel mortgage under Australian law (subject to the individual requirements of some of the States) even though it is not registered under the Act. Registration is not a condition of validity as between the mortgagor and a mortgagee(s) but an unregistered mortgage does not bind third parties who do not have notice of it.

2.33 Under Section 39 of the Act, where more than one mortgage is registered in respect of the same ship or share therein, priority among the mortgagees is determined in accordance with the order of registration of the

mortgages, irrespective of the dates on which they were made or executed and notwithstanding any express, implied or constructive notice.

2.34 In addition, where the mortgagor is an Australian company (as opposed to an individual), the mortgage must be registered against that company in the State or Territory of its incorporation and in any other State or Territory of Australia where that company carries on business, within 21 days after its creation. Failure to do so renders the mortgage void against a liquidator or creditor of the company.

2.35 An Australian ship is not obliged to carry any record of mortgage on board, although (as we shall see later) it is prudent from a lender's point of view that it should do so.

Transfer and discharge of mortgage(s)

2.36 A transfer of mortgage under the Act is effected by completion and due execution of an instrument of transfer (Section 42). Provision is also made for transmission of the interest of a mortgagee by operation of law or by lawful means other than transfer by an instrument of transfer (eg upon the death of a mortgagee under Section 43). Those provisions are also subject to Section 48 of the Australian Shipping Commission Act (discussed above) as are the provisions of Section 37 of the Act, which deal with transmission of a ship itself or a share therein by operation of law.

Disposal of Australian ship by a mortgagee

2.37 Clause 41 enables the mortgagee of a ship or a share therein to dispose of such ship or share, and to give effectual receipts in respect of the disposal thereof, subject to the qualification referred to in paragraph 2.36 above. However, where there are two or more mortgagees, a subsequent mortgagee is not entitled, in the absence of a court order, to dispose of such ship or share without the consent of every prior mortgagee.

Disposal of an Australian ship by the Owner

2.38 The sale of an Australian ship (to a person or body qualified to own an Australian ship) without simultaneous discharge of any registered mortgage, will be subject to that mortgage (Section 45). The sale of an Australian ship to a person or body which is not qualified to own an Australian ship will result in the register being closed, although any mortgage on such a ship would be enforced by courts in Australia.

Registered Agent

2.39 Section 64 of the Act makes provision for a Registered Agent to be entered in the Register in respect of every registered ship. In the case of a small craft operated solely by Australian residents and/or Australian nationals, the Registered Agent is deemed to be the operator of the ship. In the case of a ship on demise charter to an Australian-based operator, the Registered Agent is deemed to be the operator of the ship. In any other case, the managing owner or ship's agent or other person who has the management of the ship is deemed to be the Registered Agent.

2.40 While the wording of Section 64 of the Act is different to Section 95 of the Merchant Shipping Act, its purpose and effect are the same. The appointment of the Registered Agent is a statutory appointment and not a contractual one, and the Act provides for service of documents on the Registered Agent in certain circumstances (eg. see Section 67 which enables the Minister to serve a notice on the Registered Agent where he is enquiring into the ownership of a registered ship). It is submitted that a Registered Agent has no authority reposed in him by virtue of his appointment, unless authority is specifically given to him by the owner (see *Frazer v. Cuthbertson* 1880).

Review by the Administrative Appeals Tribunal

2.41 Under Section 78 of the Act, applications may be made to the Administrative Appeals Tribunal for review of:-

- (a) a decision of the Minister not to permit a temporary pass to be issued; or
- (b) a decision of the Registrar in relation to the determination of the length of a ship under Section 10(2), a refusal to extend a provisional registration certificate under Sections 21(5), 22(4), 22(6) or 65(4), disallowance of a proposed name under Section 27(3), a refusal of the Registrar to accept a document under Section 88(3), and applications for registration to which the provisions of Section 89 of the Act apply.
- (c) a determination by the Registrar in relation to the proposed transfer of a ship from a foreign registry under Section 87(1), or a refusal to make such a determination; or
- (d) a decision by an Australian diplomatic or consular representative under Section 22(1) not to issue a provisional registration certificate.

Appeals to Supreme Courts etc.

2.42 The Supreme Courts of the States and Territories are empowered to determine:-

- (a) any dispute as to ownership of a ship registered in Australia or as to any other matters noted on the Register (Section 59).
- (b) mortgages outstanding on ships about to be removed from the Register (Section 66)
- (c) forfeiture proceedings (Section 70).

Section 81 of the Act specifically confers such jurisdiction on the Supreme Courts of each Territory to the extent permitted by the Constitution. An appeal lies to the Federal Court of Australia in relation to the exercise by Supreme Courts of their jurisdiction under Section 82(1), Sections 59, 66 and 70. Under section 82(2) an appeal lies to the High Court ((with special leave) from a decision of a Supreme Court.

Transitional Provisions

2.43 Part VII of the Act is designed to ensure a smooth changeover from the Merchant Shipping Act in the first six months and the provisions of Sections 85, 86 and 88(1) have already been dealt with in paragraph 2.03 above. Section 87(1) provides that where a ship which is registered on a foreign register under provisions corresponding with the Merchant Shipping Act (or which are determined by the Registrar to correspond to a sufficient extent for the purposes of the Section) the ship may (if it is permitted to be registered, and shall if it is required to be registered) be registered under the Act within 6 months after the commencement of the Act. However, registration cannot be effected unless and until the Registrar receives certain information from the foreign Registrar concerned and such foreign Registrar consents to the closing of the registration of the ship in the foreign registry.

2.44 Under Section 89, if an application for registration under the Merchant Shipping Act is not finalized before the commencement of the Act, the Registrar is obliged to treat the application as if it had been made under the Act, provided that he is satisfied that the requirements of the Act and the MSA in relation to such application are substantially similar.

2.45 However, the Act also empowers the Registrar to make enquiries with a view to ascertaining whether ships automatically registered on the Australian Register by virtue of Section 86, are entitled to remain registered. Under Section 92, the Registrar may serve a notice on the Registered Agent of a ship requiring him to verify any

matter or particular appearing on the British Register of Ships in relation to that ship or to furnish such information and documents relating to an application for such registration within 30 days. Section 93(1) empowers the Registrar, after the expiration of 6 months from the commencement of the Act, to serve a notice on the owner and mortgagee(s) of a ship (if any) where he has reason to suspect that a ship deemed to be registered under Section 86 of the Act is not entitled to be registered. In this event satisfactory evidence must be produced to the Registrar within 3 months that the ship is entitled to be registered and, if not, the Registrar is obliged to close the registration of that ship (Section 93(2)). The provisions of Section 78 (relating to reviews by the Administrative Appeals Tribunal) and Section 81 (relating to the application to the Supreme Court of a State or Territory) are not expressed to apply to Section 93. It is to be hoped that the Regulations will give the Registrar some flexibility where there is an undischarged mortgage, so that a registered mortgagee will not necessarily be deprived of a registered security where an owner refuses to supply information and evidence requested by the Registrar.

Conclusion

2.46 The effect of the ownership provisions of the Act is that it will not be possible for non-Australian citizens and corporations to have an interest in a ship registered in Australia unless they can bring themselves within the provisions of Section 8(1)(b) or (c) (which permit foreigners to hold a minority interest) or Section 14(d) (which applies to a foreign owned ship which is demise chartered to an Australian-based operator). Where foreign interests wish to have more than a 50 per cent interest in an Australian ship (other than as permitted by Section 14(d)), they will have to incorporate an Australian company and register the ship in the name of that company.

2.47 However, the Act is sufficiently flexible to enable foreign buyers under CIF export sales contracts to participate in the Australian carriage of cargoes which they have arranged to buy. As a result, a wider group of potential operators will be able to utilize Australian tax benefits, and this will undoubtedly present opportunities for those operators to obtain tax benefits in more than one jurisdiction. Some of these aspects are discussed in further detail in Section 3 of this paper.

SECTION 3 - LEVERAGED LEASE FINANCING

Introduction

3.01 The structure of ship finance transactions varies with the requirements of the ultimate user of a ship and the amount of finance required.

3.02 The traditional forms of finance used in Australia have largely followed the London pattern which tends towards direct financing of shipowners by both single lenders and syndicates. In addition, there is a well developed system of tax leasing in the U.K. which, in many cases, confers very substantial benefits on the operator of a ship.

3.03 The last 2-3 years have seen the rapid development in Australia of our own system of tax leasing, known as leveraged leasing.

3.04 Leveraged leasing is a technique of financing which was developed in the United States in the late 1960's to facilitate the financing of large items of equipment, such as railroad equipment, aircraft and ships. A leveraged lease involves cash timing benefits and the taxation benefits of ownership under the Income Tax Assessment Act, 1936 (C'wealth) (the "Tax Act") and the leveraging of those benefits by way of limited recourse loan debt. In this way it is often possible to finance the acquisition of a ship at an effective cost which is lower than alternate means of financing, some of which have already been referred to in paragraph 3.02 above.

3.05 The general principles can best be explained by taking an example and tracing the steps involved in the leveraged lease financing of a ship from the point of view of both the financing parties and the operator of the ship. In view of the developments on the North West Shelf which are referred to in the general introduction to this paper, it is proposed to look at a possible leveraged lease financing transaction for an LNG carrier, which will be registered as an Australian ship under the Shipping Registration Act. However, it should be emphasised that the same general principles will apply to the leveraged lease financing of a tanker, bulk carrier, tug or a fishing vessel.

3.06 Let us assume that our LNG carrier is to be built in Japan and operated by an Australian liquified natural gas producer (the "Australian Producer") who is selling the gas to Japanese buyers on CIF terms providing for payment in \$US and \$A. A simplified model of a possible leveraged lease financing structure is set out in diagrammatic form in Schedule 3 to this paper.

Structure of the Transaction

3.07 Let us assume that the acquisition of the LNG carrier and the leveraged lease transaction are structured in various stages as follows:-

Stage 1

After signing the CIF terms contract with the Japanese buyers, our Australian Producer calls for tenders from leveraged lease packagers and after a review of all the tenders, a mandate for a leveraged lease is awarded. The successful packager then analyses our Australian Producer's likely cash flow and calculates the optimum deal for him; using a sophisticated computer program;

Stage 2

Our Australian Producer then enters into negotiations with a Japanese Shipbuilder, and agreement is reached on such matters as the timetable for construction, the purchase price of, say, \$A100 million and the manner in which it is to be paid;

Stage 3

The packager approaches a group of Australian Banks and Finance Companies (the "Equity Participants") and they agree to finance 10% of the overall cost of acquiring the LNG carrier, by way of a capital contribution to be made on the date of completion and delivery of the ship. The Equity Participants form a special purpose partnership for the sole purpose of entering into the various transactions comprising the overall leveraged lease transaction. For reasons which will be explained later, the Equity Participants appoint ABC Leasing Limited as their nominee and agent to enter into all such transactions on their behalf. ABC Leasing Limited is a special purpose company incorporated specifically for the present transaction.

Stage 4

A consortium of lenders (the "Debt Parties") are approached and they agree to finance the remaining 90% of the acquisition cost of the LNG carrier, by making a series of loans in \$A and \$US on a limited recourse basis to ABC Leasing Limited (as nominee and agent of the Equity Participants), to enable the purchase price instalments to be paid under the Shipbuilding Contract;

Stage 5

After the financial arrangements have been made, our Australian Producer and ABC Leasing Limited (as nominee and agent) enter into a formal contract (the "Shipbuilding Contract") with the Japanese Shipbuilder, on terms providing for property and title in the LNG carrier to vest in ABC Leasing Limited as the ship is constructed;

Stage 6

Security is given to the Debt Parties in the form of a Contract Assignment and a Refund Guarantee Assignment (in respect of all the right title and interest of ABC Leasing Limited and our Australian Producer under the Shipbuilding Contract and a Refund Guarantee issued by a Japanese Bank as security for all sums refundable by the Japanese Shipbuilder under the Shipbuilding Contract). Additional security is given at Stage 10;

Stage 7

After it has been launched, the ship is capable of navigating the high seas and therefore satisfies one of the requirements for registration on the Australian Register of Ships. Application for registration of the ship is lodged with the Registrar of Ships in Canberra;

Stage 8

Upon completion of sea trials and all dockside tests, the LNG carrier is ready for delivery. ABC Leasing Limited (as nominee and agent) makes a final borrowing from the Debt Parties and pays the amount obtained (together with the capital contribution referred to in Stage 3) to the Japanese Shipbuilder. ABC Leasing Limited then takes delivery of the ship;

Stage 9

ABC Leasing Limited (as nominee and agent) leases the LNG carrier to our Australian Producer by way of a bareboat charter (the "Bareboat Charter") for a term of 12 years;

Stage 10

ABC Leasing Limited (as nominee and agent) gives a mortgage over the ship to the Debt Parties together with an assignment of (a) the ship's Hull, Protection and Indemnity and War Risks Insurances (b) requisition compensation in respect of the ship and, in some cases, (c) an assignment of the ship's earnings.

Commentary on the Structure

3.08 Stages 1 and 2 fall outside the strict scope of the leveraged lease transaction, and they will not be the subject of further comment in this paper.

Stage 3

Formation of the Partnership

3.09 There are a number of advantages to be gained in the formation of a special purpose partnership:-

- (a) The formation of a partnership under the Tax Act enables the Equity Participants to elect under Section 56 of the Tax Act to change the method of depreciation from the diminishing value method to the prime cost method at the optimum time. This permits the Equity Participants to obtain the maximum benefit from the depreciation deduction available to them, as the ship can be treated independently of any other ships or equipment which may be owned by the Equity Participants outside the partnership.
- (b) Secondly, the size of the capital contribution (i.e. \$A10 million) to be provided by the Equity Participants towards the cost of acquiring the LNG carrier and the size of the tax benefits available, not to mention the desire of banks and finance companies to spread their investments, inevitably leads to a number of Equity Participants being required.

3.10 The definition of "partnership" under the Tax Act is rather wider than the corresponding definition in the Partnership Acts of the various States. The definition embraces partnerships recognized by the various Partnership Acts AND any association of companies which are in receipt of income jointly, even though they are not in law a partnership. Therefore, the broad scope of the definition is of considerable assistance to the Equity Participants in a leveraged lease transaction.

3.11 It is worth noting in passing that cases have arisen in the past where Equity Participants do not want to have a partnership at law. Certain of the Australian Trading Banks feel very strongly about this because Section 63 of the Banking Act, (C'wealth) provides that a bank cannot enter into an arrangement or an agreement for the carrying on of business in partnership with another bank. While the commonly held view is that Section 63 relates only to banking business (which excludes leveraged leasing) it is not uncommon for the relationship between two or more banks to be described as a participation, and not as a partnership.

Appointment of the Nominee and Agent

3.12 Equity Participants in a leveraged lease transaction normally wish to isolate themselves as much as possible from the transaction. They usually do so by appointing an A.C.T. Company as their nominee and agent, and ABC Leasing Limited fulfils that role in the present example. The main reason for this approach is to enable the Equity Participants to avoid having the ship mortgage and assignment referred to in Stage 10 registered against them under the various Companies Acts, particularly in States where stamp duty may be attracted as a result. It is thought that if the Equity Participants appoint a nominee, the charge need only be

registered against the nominee as the person creating the charge. In practice a charge is usually registered against the nominee only in its place of incorporation, which is almost invariably the A.C.T.

Stage 4

Borrowing of Funds

3.13 It is fundamental to our leveraged lease transaction that the funds required to repay the Debt Parties and to give the Equity Participants the balance of their return (after taking into account the tax benefits available to them) should come from the charter-hire and other moneys to be paid by the Australian Producer to ABC Leasing Limited under the Bareboat Charter. If, for any reason, the Australian Producer fails to pay the charter-hire, then the Equity Participants as borrowers are not obliged to repay the loans obtained from the Debt Parties. The recourse of the Debt Parties as lenders is limited to the moneys paid to ABC Leasing Limited by the Australian Producer under the Bareboat Charter and the security in the form of the Contract Assignment, the Refund Guarantee Assignment, the ship mortgage and the other assignments referred to in Stage 10. If any part or all of the charter-hire is paid, the Debt Parties receive their share of it first and the Equity Participants then receive the balance. In other words, the Debt Parties are preferential creditors and the Equity Participants are subordinated to them, so far as the charter-hire the securities are concerned.

3.14 The assumption has been made that the loans from the Debt Parties will be made available in \$A and \$US, with the result that they will match the currencies in which payment is to be made under our CIF terms contract referred to in paragraph 3.06. Consequently, our Australian Producer will be able to utilize the revenue received under his export contract in making payments of charter-hire under the Bareboat Charter to ABC Leasing Limited for the benefit of the Equity Participants and the Debt Parties. The advantage of such an arrangement from the point of view of our Australian Producer is that he will not have a currency exposure.

Stage 5

3.15 As ABC Leasing Limited (as nominee and agent) can only make payments under the Shipbuilding Contract to the extent to which it receives funds from the Debt Parties, the Equity Participants will want to ensure that the Australian Producer remains primarily liable to pay the purchase price instalments under the Shipbuilding Contract. Therefore, they will limit the obligations of ABC Leasing Limited to make payments on their behalf, to the amount of funds which ABC Leasing Limited obtains from time to time from the Debt Parties.

Stage 6

3.16 A Contract Assignment and a Refund Guarantee Assignment are the most common forms of security, although it is not unheard of for a builder to be required to put up a performance bond or guarantee. In this case the Debt Parties would also receive an assignment of such performance bond or guarantee.

State 7

3.17 While it is possible to supply some of the documents required at the outset (see paragraph 2.18 above) others, such as a Builder's Certificate and a Bill of Sale, will not normally be available until delivery. Nonetheless, it is possible for the preliminary arrangements to be sorted out so that all the registration procedures can be completed and the ship registered on the Australian Register of Ships before it leaves Japan.

Stage 8

Delivery of the Ship

3.18 A few days before delivery, an Australian Department of Transport Surveyor will travel to Japan to conduct inclining experiments on the ship. If the application for registration has gone smoothly, he will also have an Australian Registration Certificate for the ship. The surveyor will carry out his experiments and ensure that the ship has been measured for tonnage and marked in accordance with the requirements of the Shipping Registration Act. If everything is in order, the Registration Certificate will then be handed to a representative of ABC Leasing Limited.

3.19 On the date of formal delivery of the ship to ABC Leasing Limited (as nominee and agent) the parties to the Shipbuilding Contract will sign a Protocol of Delivery and Acceptance and the Japanese Shipbuilder will execute and deliver to the representative of ABC Leasing Limited a bill of sale, together with a builder's certificate.

Stage 9 - Leasing of the vessel by way of Bareboat Charter

3.20 The Bareboat Charter sets out the terms and conditions upon which our Australian Producer is able to use the ship. The Equity Participants will be concerned to protect their investment in the ship, while the Debt Parties will wish to ensure that no action is taken by the Australian Producer which might prejudice their security or their right to repayment of their loans. For its part, the Australian Producer will want freedom to operate the ship and earn sufficient revenue to make the required payments of charter-hire. The result is that our Australian Producer will probably be called on to give the following covenants to the Debt Parties and the Equity Participants in relation to the ship:-

- (a) to insure and keep the ship insured at its own expense against:-
 - (i) Fire and usual marine risks (including excess risks),
 - (ii) war risks,
 - (iii) protection and indemnity risks, including pollution risks,and to give further covenants which are incidental to such insurances;
- (b) to ensure that nothing is done whereby the registration of the ship as an Australian ship may be forfeited or imperilled;
- (c) to ensure that the ship is not employed in any trade or business which is illegal or which may render the ship liable to destruction, seizure or confiscation;
- (d) not, without the prior consent of the Equity Participants and the Debt Parties, to make any modification to the ship involving a material alteration of her structure, type, machinery, or performance characteristics;
- (e) to keep the ship in a good and efficient state of repair so as to preserve the ship's classification and not to do anything whereby such classification may be imperilled;
- (f) to submit the ship regularly to such periodical or other surveys as may be required for classification purposes;
- (g) to permit surveyors appointed by the Equity Participants and the Debt Parties to inspect the ship at all material times;
- (h) to pay and discharge all debts, damages and liabilities which may give rise to maritime or possessory liens or other claims enforceable against the ship and in the event that the ship is detained or arrested, to procure her release;
- (i) to promptly pay all tolls, dues and other outgoings in respect of the ship;
- (j) to ensure that the ship complies at all times with all relevant rules, regulations and statutory requirements applicable to the

- ship at any place where the ship may call;
- (k) not to sub-let the ship by way of bareboat charter nor by way of a time or consecutive voyage charter for a period which (together with optional extensions) is likely to exceed nineteen (19) months duration without the prior consent of the Equity Participants and the Debt Parties. In any event, one would expect to find an absolute prohibition against sub-letting for a period which is likely to go beyond the term of the Bareboat Charter itself;
 - (l) not to place the ship in the hands of any shiprepairer or other person who may be entitled to exercise a lien or right of retention unless such person has waived his rights, or the amount of the repairs is below an agreed figure;
 - (m) to place on board the ship a notice showing the name of her owners, the names of the mortgagees and indicating that the Master of the ship has no authority to create, incur or permit any liens to be imposed on the ship, except liens for crew's wages and salvage.

Tax Indemnities

3.21 A significant proportion of the Equity Participants' return on investment comes from the taxation benefits of ownership. As our LNG carrier will be trading overseas, the investment allowance will not be available. Therefore, the Equity Participants will be relying to a large extent on the benefits of depreciation to give them their return. They will expect the Australian Producer to guarantee that those benefits will be received and will be available at the time the Equity Participants anticipate receiving them. In the event that they are not, our Australian Producer will be called on to indemnify the Equity Participants.

3.22 The return to the Equity Participants will be specified in the documentation, together with the assumptions on which such return has been calculated. Such assumptions would, typically, include the following:-

- (a) That delivery of the ship under the Bareboat Charter will take place on a specified date. Delay in delivery of the ship may be very expensive for our Australian Producer, if it causes delay in the Equity Participants receiving a tax allowance;
- (b) That the Bareboat Charterparty constitutes a charter and not a hire purchase agreement. Otherwise, the Equity Participants will not be entitled to

depreciation and the other taxation benefits of ownership;

- (c) That the Australian Commissioner of Taxation will treat the partnership consisting of the Equity Participants as a partnership for the purposes of the Tax Act and will permit the partnership to adopt as its year of income a 12 month period ending 30th September;
- (d) That there will be allowed as a deduction from the assessable income of the Equity Participants during each year of income:-
 - (i) depreciation on the cost of the ship, commencing with the diminishing value method at a specified rate per annum and changing over to the the prime cost method at the optimum cross-over point utilizing a specified prime cost depreciation rate per annum, and that this deduction will commence on the date referred to in sub-paragraph (a) above;
 - (ii) interest paid or payable in respect of moneys borrowed from the Debt Parties from time to time for the purpose of financing the cost of construction of the ship, including interest paid or payable before delivery of the ship;
 - (iii) the management fees payable to the leveraged lease packager;
- (e)
 - (i) That the instalments of charter-hire payable by our Australian Producer under the Bareboat Charter will be paid on the dates and in the amounts specified in the Bareboat Charter;
 - (ii) That the instalments of interest referred to in sub-paragraph (d)(ii) above will be paid on the dates and in the amounts specified in the loan agreements with the various Debt Parties;
- (f) That the payments of charter-hire receivable by ABC Leasing Limited will be brought to account for the purposes of determining taxable income in the years in which they are due and receivable;
- (g) That the residual value of the ship at the end of the Bareboat Charter has been accepted by the Australian Commissioner of Taxation for the purpose of the Bareboat Charter;
- (h) That the corporate income tax rate on delivery of the ship is 46%;

- (i) That the method and timing of payment of corporate income tax pursuant to the Tax Act by the Equity Participants at the date of the Bareboat Charter will be unaltered;
- (j) That no withholding tax is payable on interest paid or payable in respect of moneys borrowed from the Debt Parties from time to time for the purpose of financing the cost of construction of the ship;
- (k) That no capital taxes or duties are payable on the export of the ship from Japan;
- (l) That no sales tax or customs duty is payable upon the importation of the ship into Australia.

Australian Producer's continued use of the ship

3.23 One of the main concerns of our Australian Producer will be to ensure that at the end of the Bareboat Charter, he can continue to use the LNG carrier or, better still, buy it. He will therefore want one or more options to renew the term of the Bareboat Charter (which he can have in law) and/or an option to purchase the ship (which he cannot have).

3.24 If our Australian producer has the right, or even an option to purchase the ship, the Bareboat Charter will be deemed to be a hire purchase agreement for tax purposes, in which case our Australian Producer, and not the Equity Participants, will be entitled to depreciation. Also the charter-hire would not be fully deductible by the Australian Producer, for part of it would be regarded as payment of instalments of the purchase price. Such a result would be disastrous from our Australian Producer's point of view, as he would not only lose deductions available to him in relation to payment of charter-hire, but he would also be obliged to indemnify the Equity Participants for the disallowance of depreciation and other tax benefits arising from ownership which were taken into account by the packager in determining his rate of return.

3.25 It is the clear understanding of all parties to every leveraged lease that the lessee will be able to buy the equipment concerned at the end of the term of the leveraged lease, on payment of the residual value. Usually lessees are prepared to take this on trust; after all it is the invariable practice of the finance industry in Australia to do this.

3.26 However, our Australian Producer may want additional comfort. In the context of the present example, this could take the following forms:-

- (a) An option or a series of options to renew the Bareboat Charter at the termination of the original charter period. This will enable our Australian

Producer to have the use of the ship for its full anticipated life and is the "safest" method to adopt; but care must be taken to ensure that a lower than commercial charter-hire during the option period does not give rise to a suggestion that the whole "arrangement" is not simply a disguised form of hire purchase agreement.

- (b) If our Australian Producer is determined to acquire ownership, the renewal device would probably not be enough. For instance, it may seek the right to control the auction sale of the ship upon termination of the Bareboat Charter. However, this is dangerous, and so is a provision which would ensure that any "excess" over the residual value received by the lessor on disposal is to be paid to the lessee. The former method would guarantee the Australian Producer the right to obtain title to the ship if it so desires, and the latter would remove all incentive for ABC Leasing Limited (as nominee and agent) to seek to sell the ship to anyone else. However, variations of each of these methods may satisfy our Australian Producer without having adverse consequences;
- (c) If a "controlled" auction sale is desired, our Australian producer would be better advised if the conduct of the auction was not in his hands, but in the hands of an associate company, which would be authorised as the agent of ABC Leasing Limited to sell the ship for a price not less than its residual value under the Bareboat Charter;
- (d) Another approach which could be used, is for an associate company of our Australian Producer to guarantee its obligations under the Bareboat Charter, in return for which ABC Leasing Limited (as nominee and agent) agrees to pay such associate any excess over the residual value which ABC Leasing Limited receives on sale of the ship at the end of the charter period.

What is essential is that the Australian Tax Office should be told the whole story when a tax ruling is requested prior to execution of the documentation.

Stage 10

The Granting of Security

3.27 As indicated in paragraph 2.29 above, there will be no prescribed form of ship mortgage under the Shipping Registration Act, and this gives the Debt Parties greater flexibility in determining the way in which the security arrangements are to be documented, and the parties to those arrangements. Apart from stamp duty considerations, which are discussed briefly below, it will be possible for a ship

Producer to have the use of the ship for its full anticipated life and is the "safest" method to adopt; but care must be taken to ensure that a lower than commercial charter-hire during the option period does not give rise to a suggestion that the whole "arrangement" is not simply a disguised form of hire purchase agreement.

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- (c) If a "controlled" auction sale is desired, our Australian producer would be better advised if the conduct of the auction was not in his hands, but in the hands of an associate company, which would be authorised as the agent of ABC Leasing Limited to sell the ship for a price not less than its residual value under the Bareboat Charter;
- (d) Another approach which could be used, is for an associate company of our Australian Producer to guarantee its obligations under the Bareboat Charter, in return for which ABC Leasing Limited (as nominee and agent) agrees to pay such associate any excess over the residual value which ABC Leasing Limited receives on sale of the ship at the end of the charter period.

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mortgage to contain an assignment of Insurances and Requisition Compensation, together with such covenants from our Australian Producer as the Debt Parties and the Equity Participants may determine.

3.28 The ship mortgage can be lodged for registration as soon as our LNG Carrier has been registered by the Australian Registrar of Ships. In any event, the Debt Parties will wish to insure that the mortgage is lodged for registration prior to departure of the ship from Japan.

3.29 As indicated in paragraph 2.34 above, the ship mortgage (and any other security obtained by the Debt Parties from ABC Leasing Limited) must be registered against ABC Leasing Limited on the A.C.T. Companies Registry. As ABC Leasing Limited has been incorporated specifically for the purpose of acting as the nominee and agent of the Equity participants, it is submitted that the mortgage will not need to be registered against ABC Leasing Limited in other Territories or States where our LNG Carrier may call during its operational service, thereby avoiding potential loan security duty problems.

Stamp Duty

3.30 No discussion on leveraged leasing is complete without some consideration of the stamp duty problems involved in setting up such a transaction. Anyone with experience of stamp duties in Australia must regard this as one of the worst features of our federal system of Government. Each State and Territory has its own peculiar stamp duty laws, many of which have been enacted without regard to their economic consequences.

3.31 The commencement of the Shipping Registration Act is going to create some fundamental problems in relation to the stamp duties legislation of some of the States. Further, it appears that these problems will not be avoided altogether by the establishment of the Australian Register of Ships in Canberra and the structuring of leveraged lease transactions for ships in the A.C.T.

3.32 It is only possible to deal in summary form with the stamp duty position in each State and Territory.

(a) Australian Capital Territory

No stamp duty is payable on an agreement for sale of a ship, a bill of sale or a ship mortgage (whether executed pursuant to the Merchant Shipping Act or the Shipping Registration Act) a bareboat charter party or a collateral security in the form of a mortgage or assignment of Insurances, where those documents are executed in the A.C.T.

(b) New South Wales

No stamp duty is payable on an agreement for sale of a ship, or the statutory forms of bill of sale and ship mortgage used under the Merchant Shipping Act, where those documents are executed in New South Wales. The position in relation to an agreement for sale, a bill of sale and (with some reservations) a ship mortgage will remain unchanged when the Shipping Registration Act comes into force. However, care will need to be taken with the form of ship mortgage, as ad valorem stamp duty will be attracted if the document contains an assignment or mortgage of insurances. Fixed duty of 50 cents is payable on a charterparty which is executed in New South Wales or which is brought into New South Wales after execution, and the duty may be denoted by adhesive stamp. The better view is that a bareboat charter of the type envisaged in the leveraged lease transaction referred to above will constitute a charterparty within the meaning of the exemption, and therefore will not be caught by the "hiring arrangement" duty provisions of the New South Wales Stamp Duties Act.

(c) Queensland

The Queensland Stamp Act does not contain any specific exemptions from duty. However, Section 721 of the Merchant Shipping Act exempts from duty "any instruments used for carrying into effect Part 1 of the Act". Part 1 covers, inter alia, transfers and mortgages of ships. It is the practice of the Queensland Commissioner of Stamp Duties not to levy duty on agreements for the sale of ships, and bills of sale and ship mortgages used under the Merchant Shipping Act, where those documents are executed in Queensland.

As the Shipping Registration Act repeals Part 1 of the MSA it appears that the exemptions from duty will no longer be available. As a result, ad valorem duty may well be payable on a bill of sale and a ship mortgage executed under the new Act.

The position of a bareboat charter executed in Queensland is broadly the same as in New South Wales. Fixed duty of \$A2 is payable on a charterparty where the total hire exceeds \$A200 and the duty may be denoted by an adhesive stamp.

(d) Northern Territory

No stamp duty is payable on a bill of sale or an agreement for sale of a ship which is executed in the Northern Territory. However, ad valorem loan security duty is payable on a ship mortgage executed in the Northern Territory, regardless of the form

which it takes. In addition, there is no specific head of duty relating to charterparties executed in the Northern Territory, and a bareboat charter may well attract ad valorem duty under the "hiring arrangement" provisions of the Northern Territory stamp duties legislation.

(e) Victoria

Under the Victorian Stamps Act, an agreement for sale of a ship is to be stamped with fixed duty of \$A5. It appears that a bill of sale (in whatever form it takes) may be liable to ad valorem duty under that Act as a "mortgage". In any event, the Stamps Office regard mortgage duty as payable in respect of a ship mortgage (in whatever form it takes). There is no head of duty applicable to charterparties, and it appears that a bareboat charter may well be liable to ad valorem duty under the "rental business" head of duty, which is somewhat similar to the "hiring arrangement" provisions of the corresponding New South Wales and the Northern Territory legislation.

(f) Tasmania

Agreements for the sale of ships are not liable for stamp duty. Notwithstanding that there are strong arguments to the contrary, it is the practice of the Tasmania stamp duties office to levy ad valorem stamp duty on the statutory forms of bill of sale and ship mortgage under the Merchant Shipping Act which are executed in Tasmania. This position is likely to continue after the Shipping Registration Act comes into force. There is no head of duty relating to charterparties in the Tasmanian Stamp Duties Act. It appears that a bareboat charterparty for a term of more than 6 months may be liable to ad valorem duty as a "rental agreement".

(g) South Australia

Under the South Australian Stamp Duty Act, nominal duty of 20 cents is payable on an agreement for sale of a ship, and the duty may be denoted by an adhesive stamp. The position in relation to bills of sale and ship mortgages under the Merchant Shipping Act and the Shipping Registration Act which are executed in South Australia is broadly the same as for Queensland. There is no head of duty relating to charterparties and it appears that they may attract ad valorem duty under the "rental business" provisions of the Act.

(h) Western Australia

Under the Western Australia Stamp Act an agreement for sale of a ship attracts nominal stamp duty of

§A5. The statutory form of bill of sale under the Merchant Shipping Act is exempt from duty. In addition, it appears that a bill of sale given under the Shipping Registration Act may still be exempt (section 74(1)), although care will need to be taken with the drafting in order to avoid the possibility of attracting ad valorem bond/covenant duty. The statutory form of ship mortgage under the Merchant Shipping Act is not dutiable, but it appears that a mortgage under the new Act will be subject to ad valorem duty. A bareboat charter party is exempt from duty.

3.33 The most favourable jurisdictions for entering into leveraged lease transactions for ships are New South Wales and the Australian Capital Territory. However, it is worth sounding a note of caution in relation to transactions to be structured in the A.C.T. Some States (particularly Victoria and South Australia) are now attempting to levy duty on transactions involving property situated in those States, regardless, of where the documentation is executed. In addition, the rental business or hiring arrangement provisions of the various Acts apply where goods are or may be used in the State concerned and either the lessor is carrying on rental business in that State (except for South Australia) or the lessee is domiciled or resident in such State.

3.34 However, there are techniques available in certain circumstances for minimizing payment of mortgage and rental business duty.

SECTION 4 - OBSERVATIONS FOR THE FUTURE

4.01 The level of natural resource exports from Australia has increased dramatically over the last 5-6 years, and present indications are that it will continue to increase over the next 10 years. While this is undoubtedly an encouraging sign, the opportunities for ship financing in Australia will ultimately depend on a number of factors which are not necessarily related to availability of bulk and liquid cargoes.

4.02 Firstly, there is an urgent need for the resource exporters, the ship owners and the Australian Maritime Unions to reach agreement on the future of "Australian" flag participation in the export trade. If a consensus can be reached on such matters as manning levels, the resolution of industrial disputes and the degree of overall participation in the export trade, then the way will be open for a thorough review by the Australian Government of its policy towards Australian shipping.

4.03 Some form of Government assistance in the form of capital and/or taxation concessions is essential if "Australian" flag participation in the export trades is to increase beyond its present minimal level. In the United Kingdom, apart from cheap finance under the Industry Act, there is available a 100% allowance on capital expenditure incurred in the first year of operation of a U.K. registered ship. The allowance may be fully used in the first year, or in succeeding years, without penalty. The article from "The Australian" which forms Schedule 1 to this paper, provides some interesting insights into the type of financial assistance which other foreign shipowners apparently receive from their governments.

4.04 In Australia, the Investment Allowance of 18% is not available where a ship is to be traded overseas. In addition, the prescribed depreciation rates for ships are very low and the current depreciation rates for various types of ships are set out in Schedule 4 to this paper. By way of comparison, it is interesting to note that depreciation for a Boeing 747 Aircraft is currently 22.125% on the diminishing value basis and 14.75% on the prime cost basis.

4.05 It is suggested that at the very least, the following incentives be offered in respect of all ships required to be registered under the Shipping Registration Act:-

- (a) Import duty of 2% to be abolished;
- (b) The Investment Allowance of 18% to be made available regardless of where the ship is traded;
- (c) Owners be permitted to depreciate their ships over a shorter period of, say, 5-6 years.

4.06 These and other issues are presently being considered by the Crawford Committee and in the event that all interested parties and the Government are able to formulate a coherent plan for increased "Australian" flag participation in the export trades, the outlook for ship financing in Australia will be very bright indeed.

Transport Australia 1980s

Local vessels to benefit from waterfront action

Unions win campaign for flag-carriers

WHENEVER disputes occur on the waterfront, and unfortunately this happens frequently, all the maritime unions come in for criticism, because to varying degree the dispute affects everyone in the community.

That, as far as the seagoing sections of the maritime unions are concerned a different side to the argument exists, is hardly ever mentioned.

All the maritime unions led by the Seamens Union of Australia (SUA) have, for decades, advocated a planned Australian shipping fleet in the overseas trade.

About 12 months ago these unions reached agreement with the oil companies that four of the multinationals would introduce Australian flagged tankers, each over 100,000dwt, to carry crude oil from the Persian Gulf to Australia.

British Petroleum is to introduce the first vessel in March or April 1982 to serve Kwinana. WA Mobil is expected to have an Australian flagged tanker in service by the middle of next year to serve Port Stanvac and Shell is to introduce a tanker to serve Sydney or Victoria in late 1982 or early 1983.

This tanker is expected to be followed by an Australian flagged Caltex tanker in the overseas trade, which will probably replace the ageing William Dampier.

The independent company of Howard Smith Industries is contemplating, in negotiation with the oil companies, to bareboat charter a tanker for the overseas trade carrying crude oil from the Persian Gulf to Australian ports.

This tanker will be of about 80,000dwt, identically manned as the Ampol Sarell, will spend about 70 per cent of its time in overseas trade and fill in for coastal tankers when these have to be dry-docked.

The tanker, which will comply with the IMCO Protocol of 1978, will have an inert gas system, crude oil washing, segregated clean ballast tanks and automatic radar plotting aid.

Although the vessel is expected to be introduced only later this year, one should not be surprised if it already becomes reality by the end of October.

This appears to fulfil the maritime unions' demand of 1978, outlined in their report of the introduction of Australian-flag tankers trading in the international trade, for a progressive scale to introduce an Australian overseas tanker fleet.

The Government is not responsible for this achievement.

Since the advent of containerisation, the Australian National Line, our largest ship operator, entered the overseas trade in 1969 in conjunction with Kawasaki Kisen Kaisha Ltd of Japan, when the Australian Enterprise, a vehicle deck cargo ship of 18,500dwt, pioneered the routes between Australia and Japan.

Until then there were no Australian ships engaged in overseas trades.

The ANL operates over 30 ships, aggregating 1,359,579dwt, of which 18 ships aggregating 885,346dwt or 65 per cent of the fleet, operate in overseas trades, carrying the Australian flag to Britain, Continental Europe, New Zealand, North America.

By CAPTAIN VIC SANDERSON

Japan, the Far East, Korea, Malaysia, Indonesia and through the PAD service links Australia with Noumea, Fiji, Hawaii and Canada.

The four "p" class ore/bulk carriers of between 122,000 and over 139,000dwt are engaged in the mineral export trade to Japan.

Although most of the ANL vessels are in conferences on a participating basis rather than an independent basis, the bulk carriers, Flinders Range and Selwyn Range, are engaged in overseas trading carrying mostly wheat.

Recently the ANL took over the charters of the three phosphate ships, Baron Murray, Cape Hawke and Cape Orway, from the former British Phosphate Commissioners, now the Australian Phosphate Commission.

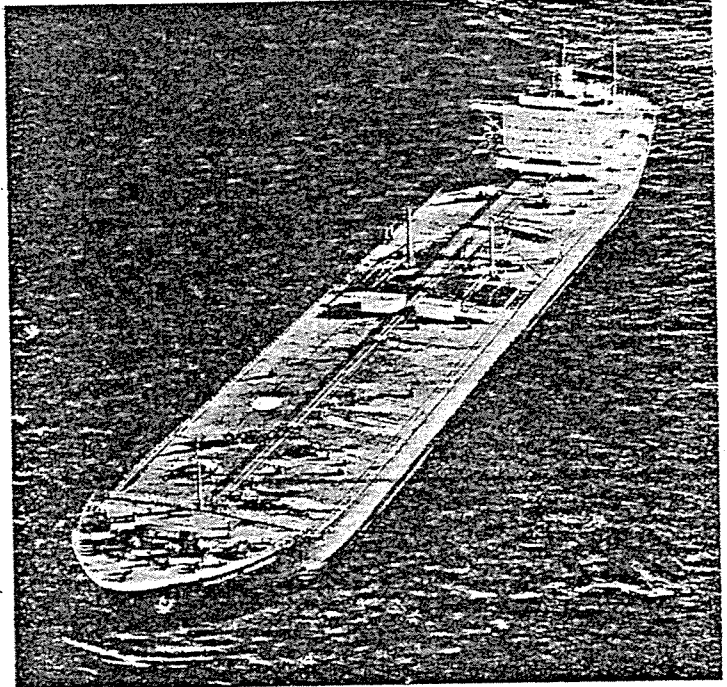
These vessels are engaged in carrying phosphate from Christmas Island and Nauru Island to Australia.

It is expected that these vessels will shortly be engaged in a triangular trade—exporting cargo from Australia and returning with phosphate.

This is quite an achievement if we consider the incentives other maritime nations give their shipping industry to earn foreign exchange.

Assistance granted by various governments changes from time to time, but the following schedule is indicative of the types of assistance granted and the disadvantage under which Australian shipping companies operate.

France: Modernisation of vessels at 3 to 5 per cent of price; income derived offshore is not taxable; 70 per



THE WILLIAM DAMPIER... likely to be replaced by an Australian-flagged Caltex tanker

cent oil imports and 40 per cent coal imports reserved for national flag vessels.

Federal Republic of Germany: 80 per cent of income from international transport taxed at 27.5 per cent, normal rate 51 per cent; 30 per cent extra-depreciation over five years modernisation loan at 6.5 per cent interest.

Japan: Operating subsidies for cross-trade carriage of 1 to 3 per cent; special depreciation allowance of 20 per cent of purchase price plus accelerated depreciation at 46 per cent in the first year; long term low interest credits.

Norway: Special depreciation allowance up to 15 per cent of the price, initial depreciation up to 25 per cent; tax deferral of 25 per cent of shipowners' profits if invested in ships, of which 15 per cent is tax free.

UK: Investment allowance 20 per cent; free depreciation 100 per cent write-off in first year.

US: Tax-free reserve funds; investment credits accelerated depreciation; operating differential subsidy.

In contrast, the Australian depreciation rate is 6.25 per cent per annum, while the 20 per cent investment is denied to shipowners on the international run.

It is obvious that the effect of the Australian legislation, if not its intention, is to actively discourage Australian owned vessels from entering international trade.

From this we can see that blaming the unions for not being capable to compete with overseas ships and that we are struggling to get crews down to 30 when overseas vessels visiting Australia have crews of 21 or less, is not accurate.

It shows the ball is squarely in the Government's court.

The maritime unions are blamed for holding up flag of convenience vessels waiting to carry Australian coal overseas and the Liberian Government has sent the unions a diplomatic note of protest.

The reality is that huge quantities of coal are shipped overseas and only one Australian vessel participates in the trade, a far cry from the Unctad resolution of 40-40-20.

The independently-owned coal carrier, Howard Smith, of 43,300dwt is the one and only Australian flagged vessel in the coal trade.

Her keel was laid in Kobe in September last, she was handed over on March 27 this year and commenced her first voyage between Sydney and Japan one day later.

She carries 38,000 tonnes coal at 11m draught from Balls Head, Port Jackson to Japan, averaging 29 days per round voyage. She has not lost one single day and always sails on time.

Small wonder that the maritime unions are rightly campaigning for the planned introduction over a period of time for Australian ships to be engaged in the coal export trade.

Going by their past track record with tankers, there can be no doubt that they will achieve this.

There is a future for Australian shipping in the overseas trades and when all these ships become operational there will be a shortage of crews and we may have to import crews from overseas.

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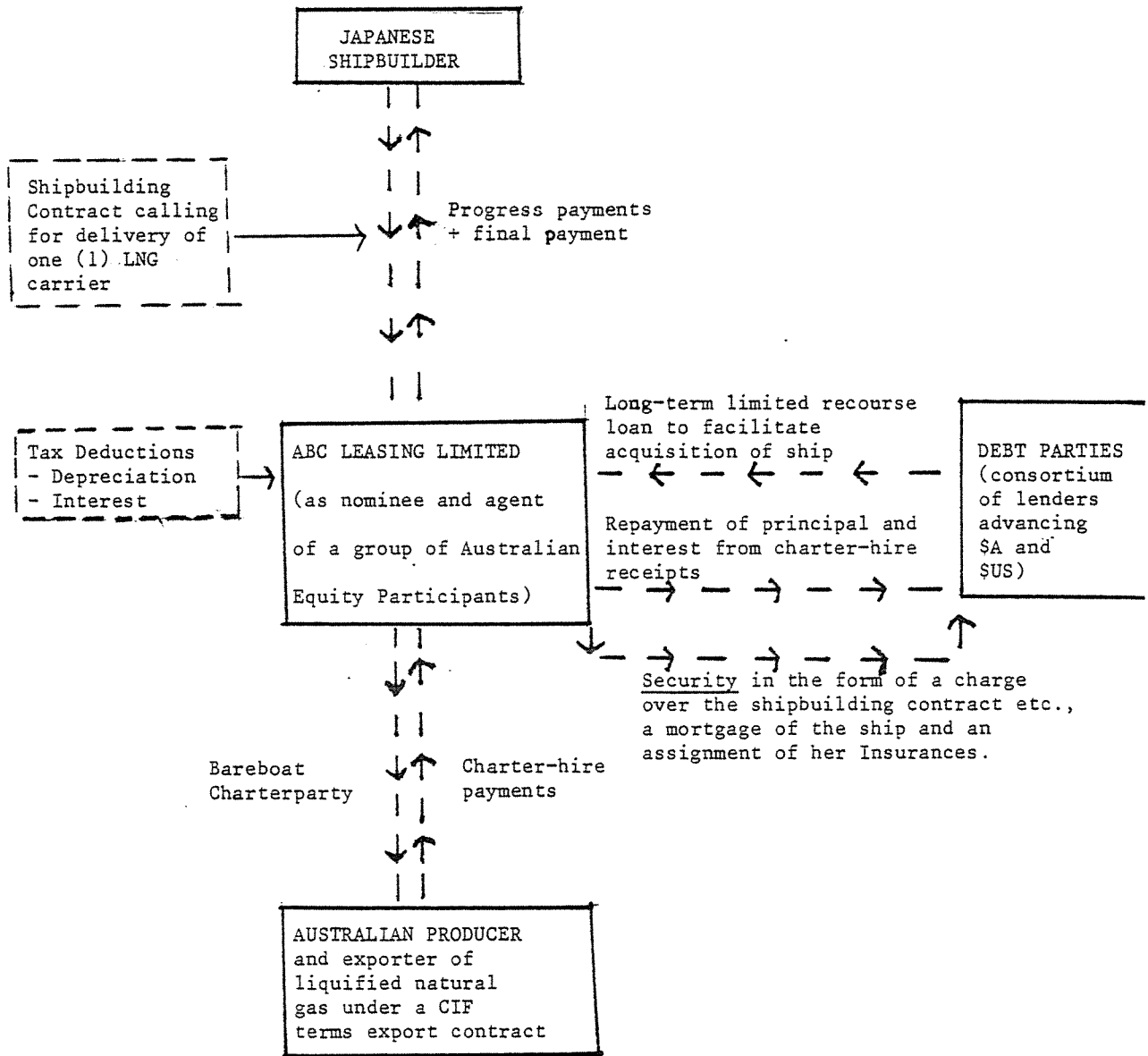
SCHEDULE 2

"BRITISH" PORTS OF REGISTRY IN AUSTRALIA

1. Queensland
Cairns
Townsville
Rockhampton
Bundaberg
Maryborough
Brisbane
Gladstone
2. New South Wales
Newcastle
Sydney
Port Kembla
3. Victoria
Melbourne
Portland
Geelong
4. Tasmania
Hobart
Launceston
Devonport
Burnie
5. South Australia
Port Adelaide
6. Western Australia
Freemantle
7. Northern Territory
Darwin

SCHEDULE 3

LEVERAGED LEASE MODEL FOR A LNG CARRIER



SCHEDULE 4

RATES OF DEPRECIATION FOR SHIPS IN AUSTRALIA

<u>Type of Ship</u>	<u>Prime cost rate (%)</u>	<u>Diminishing value rate (%)</u>
1. Bulk carriers	6 $\frac{1}{4}$	9 $\frac{3}{8}$
2. Coal hulks	6	9
3. Container ships	6 $\frac{1}{4}$	9 $\frac{3}{8}$
4. Flexible barges (collapsible bag type)	15	22 $\frac{1}{2}$
5. Roll-on/Roll-off ships	6 $\frac{1}{4}$	9 $\frac{3}{8}$
6. Ships and steamers	5	7 $\frac{1}{2}$
7. Tankers (engaged primarily and principally in the tanker trade)	6 $\frac{1}{4}$	9 $\frac{3}{8}$
8. Tugs	5	7 $\frac{1}{2}$

The above figures are taken from Income Tax Order No. 1217 and are subject to an additional loading of 18%.